EDITORIAL

Oil production in Ghana:

Should the celebrations start?

The announcement that oil had been discovered in commercial quantities in Ghana in June 2007 came with great jubilation from all quarters of the country. In February 2008 the government organised a national forum on managing oil. This was in response to concerns raised by many commentators that oil production and the expected revenue stream offers no guarantee that the country's problems will go away.

Ghana's economy has seen significant improvements since the 1990s with an annual growth rate of about 4.7% over the period 1990-2007. Importantly, the growth in the economy has been associated with an appreciable reduction in the incidence of poverty. The poverty headcount index fell from 52% in 1991/92 period to about 28.5% in 2006. However, inequality has widened over this period with the *gini* coefficient increasing from 0.373 in 1992 to 0.394 in 2006.

Fiscal consolidation however remains a problem even though revenue effort plus foreign aid has improved significantly over the years. Tax revenue has increased over the years and has been able to influence the trends in Government revenue in a positive direction. However, this positive achievement with respect to revenue generation has been outpaced by Government expenditures. Total Government revenue as a percent of GDP increased from 17.7% in 2000 to 26% in 2007 as compared to Government expenditure which correspondingly increased from 24.5% as a percentage of GDP in 2000 to about 44.8% in 2007. The net result has been a worsening of the overall fiscal balance. From a deficit position of 3.0% of GDP in 1996 it increased to about 8.5% in 2000, and improved marginally to about 8.1% of GDP in 2007.

The main components of export remain cocoa and gold. Their joint contribution to total exports range from a high of 74% in 1996 to a low of 54% in 2001. There has been a worsening trade deficit especially from 2004 to date. This is a result of increasing import bill. Undoubtedly the higher oil import bill as a result of the unprecedented hikes in the price of oil in the global market is a part of the reason. Additionally however, non-oil imports have also increased much faster than exports over this same period.

n commercial quantities in Ghana is expected to start in 2010. The reserve discovered so far is estimated at about two billion barrels in total and is expected to last for twenty years in full production. In 2010 when production begins, about 120,000 barrels are expected to be produced daily. With a conservative price estimate of about US$70 per barrel, oil revenue to Ghana will be in the region of about US$1.22 billion in 2010. This is expected to increase to about US$2.54 billion by 2012 when production is expected to rise to about 250,000 barrels a day. Obviously these are quite significant inflows when compared with the fact that total grants and loans in 2007 was about US$1.34 billion. It is anticipated that oil production in Ghana will solve a number of problems including the increasing oil import bills that remain a major challenge for the economy today.

There is no doubt that the expected revenue stream from oil production in Ghana will significantly complement current efforts to move the country to middle income status. A good example is when one considers that the overall funding gap for the Growth and Poverty Reduction Strategy (GPRS II: 2006-09) is estimated to be about US$1.79 billion. This financing gap which is expected to be filled by the external inflows and resources from the capital market can be financed with a year's revenue from oil. Indeed, oil revenue is expected to become the most important export earner for the country contributing about 60% to the total exports by 2012.

Notwithstanding the numerous expected gains from oil production, a lot of reservations have been expressed over the possibility of a '*resource curse*' setting in. A significant body of research over the last twenty years has shown that natural resource endowment of many developing countries adversely affected the efficiency with which they have used their capital. This phenomenon can cause a decline in productivity in the agricultural and the manufacturing sectors, resulting in increased unemployment.

If the current underperformance of the manufacturing sector is anything to go by, then there is a higher risk of Ghana experiencing the phenomenon, known as the *Dutch disease*. For instance, it is observed that in recent years when foreign inflows have increased, it has been associated with real appreciation of exchange rate and an increasing trade deficit. Should foreign earnings double with oil production, it will definitely cause further appreciation in real exchange rate with possible adverse consequences for the real sector, particularly manufacturing and agriculture. Locally produced goods and services will eventually lose out to competition.

Resources will need to be spent in a way that ensures increasing productivity to compensate for any loss in competitiveness that will result from a real appreciation of the currency. With the current state of our democratic governance, rent-seeking activities associated with oil-producing developing countries can be minimised. Furthermore, Ghana has the benefit of learning from the experiences of other oil producing countries. It is therefore important that the country continues to grow institutions for proper economic management and governance to be able to fully reap the development benefits from the oil find.