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IMPLICATIONS OF LOW OIL PRICE ON AFRICA'S OIL PRODUCING ECONOMIES

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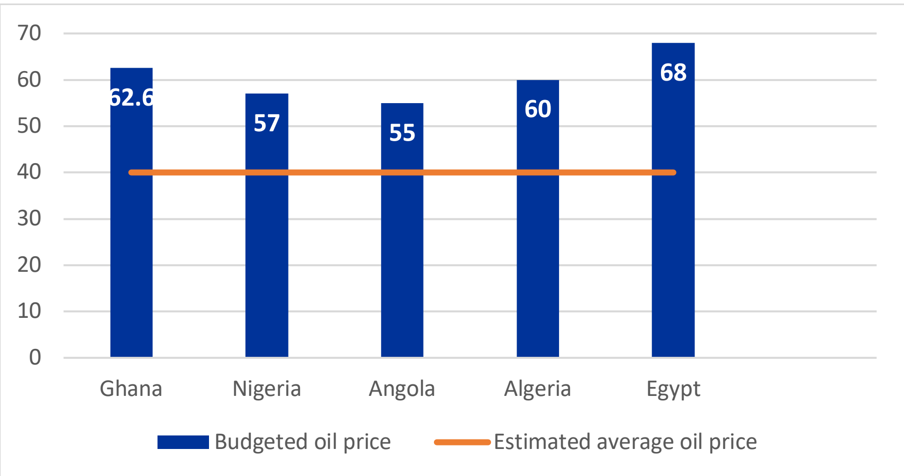
The plummeting global crude oil price in recent times has become an alarming situation that threatens the cash flow of oil companies and revenue of governments. Brent Crude oil price has declined dramatically from $66.25 to $26 per barrel between 2nd January 2020 and 21st March 2020. This fall in oil price is linked with the outbreak of COVID-19, which has affected global economic growth and demand for oil, thus creating excess oil supply.

The traditional geopolitical mechanics to check excess supply of oil has also failed to work. Historically, the major cartel, Organisation of Petroleum Exporting Countries (OPEC) and other large oil producers have managed oil market glut by cutting production to check falling prices. However, two important players, Saudi Arabia and Russia who together supply about 22 percent of global oil demand have failed to reach a deal on production cuts and are rather engaged in a price war. To Russia, low oil price is a tool to hurt the production boom of shale from US. In what can be described as *the grass that suffers when two elephants fight*, the effect could be a sustained low oil price which poses significant threat to projections of oil producing African countries whose budgets are heavily reliant on oil revenue.

In ACEP's estimation, governments' projection of oil revenues will experience a shortfall of between 40 to 55 percent in oil producing countries in Africa. Projected oil prices in the 2020 budgets of these countries is about $55 to $68 per barrel (See Figure 1). Given the current global economic condition, effects of COVID-19, and Russia's quest to sustain oil price below the marginal cost of shale production, oil price recovery is expected to be in the region of $45 per barrel by the end of 2020. Therefore, the likely average oil price is estimated to be about $40 per barrel for the year.

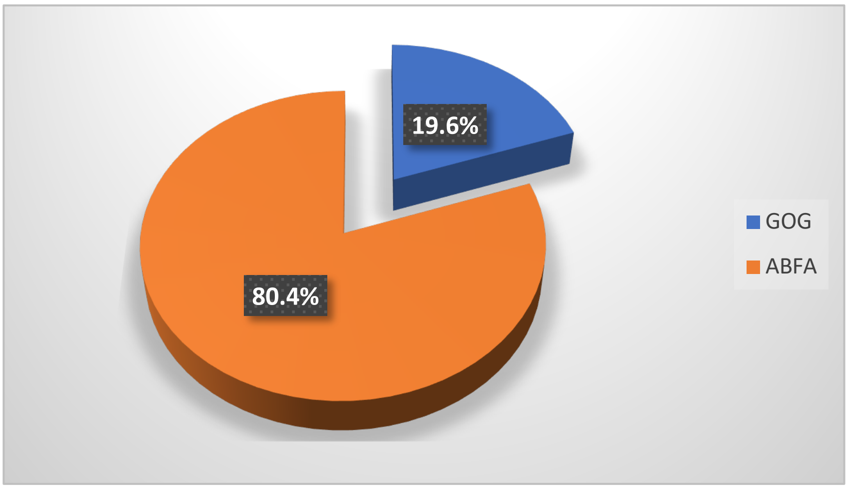
Figure 1: Projected oil prices in five oil producing countries in Africa



Implication for Ghana

In the case of Ghana, government projected to receive $1.567 billion from oil revenues, anchored on a price prediction of $62.6[1] per barrel. Based on the average price prediction of $40 per barrel, the receivables from oil could drop to $743 million, a shortfall of about 53 percent. This has severe implications for the budget particularly physical infrastructure and debt servicing. In the 2020 budget, Ghana's infrastructure development programme is heavily dependent on oil revenues; about 80% of government's domestic revenue for its capital budget was to be sourced from the Annual Budget Funding Amount (ABFA) (Figure 2).

Figure 2: Breakdown of government's domestic revenue for capital budget for 2020



ACEP estimates show that maximum allocation to the ABFA for the year in line with the Petroleum Revenue Management Act (PRMA) will significantly drop from $761 million to about $273 million representing a shortfall of about 64 percent. This shortfall of $488 million cannot be smoothened by the Ghana Stabilisation Fund (GSF) established by the PRMA. At a standing balance of $300 million, the maximum withdrawal from the GSF compliant with the PRMA will be about $243 million. Though this provides support and reduces the price shock on the ABFA component of the budget, the inadequacy of the GSF to offset the entire deficit exposes the failure of the capped balance of $300 million to provide enough support to the budget in periods of a quantum drop in oil price as being experienced currently. This is the second time the inadequacy of GSF has been exposed by oil price shocks since commercial oil production started in Ghana a decade ago.

Government's projected transfers into GSF in 2020 is $228 million. Given that GSF is capped at $300 million, the $228 million would have been excess over the cap and available for debt service and/or contingency, in compliance with the PRMA. Over the years, excess over the cap has been used largely for debt service which indicates that the $228 million, which is about 5.7 percent of the programmed expenditure for interest payment in 2020, will not be available for debt service. This creates additional pressure on the government to look for other revenue sources to offset the gap in debt service allocation.

[1] Earlier versions of the 2020 budget quote oil price as $58.66 per barrel and total revenue of $1.15 billion.

Recommended actions

1. **Governments should ensure the transmission of the lower oil price to support industry and consumers of petroleum products.** In Africa, the effect of the COVID-19 outbreak could be harsh for emerging SMEs and industries that are struggling to compete in the global space. Increased unemployment as a result of layoffs on the back the pandemic is possible to occur. In a low oil price era, the temptation for many countries could be to increase taxes on downstream consumption to offset the revenue losses upstream. This will be injurious to many businesses in Africa, particularly in the face of inadequate incentives and stimuluses compared to the developed countries. A full transmission of the lower price of oil is therefore required for businesses and consumers in general to boost economic activity. This minimises production and service delivery costs to reduce the burden on consumers.
2. **A new budget that accounts for the extraordinary drop in oil prices is required for oil producing countries in Africa.** It is encouraging to see that Algeria has already recognised this fact and is preparing a supplementary budget that will help manage the effects of low oil price. This also recognises that a mid-term budget will be too late for many countries to accommodate the full effect of oil price drop and the impacts of COVID-19 outbreak on the national budget.
3. **In future, governments must implement significant countercyclical mechanisms.** An option will be for governments to have stabilisation funds with adequate buffer that is capable of smoothening significant shortfalls in the budget. Also, hedging portions of oil outputs will minimise the impacts of oil price volatility on national budgets.

Signed
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