CHAPTER

5 Persistent Surpluses and Accumulation of Assets

Background Discussion

We have presented the rationale for saving at least some of the current oil revenue. The question remains whether savings should be used for (1) repayment of existing government debt, (2) investment in domestic assets, or (3) investment in external assets. In some countries, debt service on existing concessional debt can be below the returns that would be achieved by investing reserves in a well-constructed international portfolio. Saving part of the oil revenue stream can, therefore, generate income-earning assets whose flows can be more than sufficient to cover existing debt-service payments. Prudence would advise against borrowing in anticipation of higher oil revenue in the future, and this includes borrowing when oil prices are thought to be temporarily below their medium-term average. Leaving aside the danger that higher oil revenue may fail to materialize, a high sovereign risk premium in oil countries in Africa can make borrowing very expensive.

Domestic investment opportunities in most African countries are limited by the small capitalization or nonexistence of capital markets and by capacity constraints. In addition, investment in physical assets has to be limited to safeguard the macroeconomic stability and competitiveness of the non-oil economy, and, therefore, part of the oil revenue would have to be sterilized. Some of the savings would thus best be invested in financial assets abroad.

It is important that all oil-related financial operations be included in the government budget and that savings funds be created as an integral part of the budgetary operations. Savings funds can be set up so that they will automatically stabilize fiscal policy as assets are accumulated according to the actual fiscal surplus achieved at the end of the fiscal year. In contrast, many countries in the past implemented allocation rules requiring, for example, that a certain percentage of oil revenue be paid into the fund. Applying this allocation rule independent of the overall fiscal position of the government can—and has in several countries (for example, Venezuela)—lead to the simultaneous accumulation of assets in the fund and government borrowing to finance an overall deficit. To avoid this paradoxical situation, savings should be determined as a residual, and the fiscal policy stance should be appropriate to produce the desired level of the overall deficit and accumulation of assets. However, in order to protect wealth on a long-term basis, legal barriers against withdrawing from a fund would probably be helpful—for example, a constitutional requirement that budgets cannot be based on withdrawals from the fund and that such withdrawals can be made only under emergency conditions and if authorized by parliament (as is the case in Kuwait and Alaska). In implementing the budget, if revenue shortfalls were to occur due to lower-than-expected oil prices or unforeseen events in the oil sector, the fund should be allowed to stabilize public spending—for example, through a supplementary budget approved by parliament.

Regarding institutional aspects, the transformation of government savings into foreign assets is a question of reserve management. Traditionally, this has been the prerogative of the central bank, and a case can be made for retaining a strong role for the central bank in the management of these oil savings. In practical terms, all oil revenue could be credited to a special treasury account at the central bank. Debits from the special treasury account would then finance the non-oil deficit, and the central bank, together with an oversight committee and, probably, some external financial experts, would determine how to invest government savings abroad.

B. Current Practice

All the countries channel at least part of their fiscal surpluses from oil revenue (insofar as surpluses exist) into treasury accounts with their central banks. Equatorial Guinea holds large deposits in a bank account abroad, in addition to contributing to reserves at the BEAC (see Table 6). The foreign bank account is not transparent; access to the account is restricted to the president. The rules of the BEAC do not allow the holding of such external deposits. Angola has reported large fiscal deficits over the last five years, and foreign exchange reserves at the central bank are low.

Table 6. Current Practice in Foreign Reserve and Debt Management

Country	Reserves in the Central Bank	Borrowing Against Oil Revenue
Angola	Trends in government deposits at the central bank have mirrored trends in oil exports.	Yes. Borrowing terms are not transparent.
Cameroon	All foreign exchange earnings mandatorily repatriated to the BEAC. Oil revenue in excess of programmed level is deposited in CFA francs in a treasury account at the BEAC to be used for priority infrastructure and social expenditure and to reduce domestic arrears.	None.
Chad	Law creating a Fund for Future Generations stipulates that assets be held with an international financial institution and invested in long-term instruments. This is inconsistent with BEAC rules.	None.
Republic of Congo	Reserves are held in the BEAC.	Extensive use of oil-collateralized borrowing from foreign commercial banks.
Equatorial Guinea	Government holds foreign exchange deposits abroad and makes contributions to reserves of the BEAC. Information on transactions on the offshore bank account lacking.	The government has been borrowing from oil companies against future oil revenue but extent and terms of such borrowing not transparent.
Gabon	Contribution to BEAC reserves declined sharply in 2001.	Gabon has never collateralized debt with oil revenue. However, the boom and bust of the international oil market were reflected in the budget's borrowing needs. Borrowing was generally carried out on unfavorable commercial terms. There are indications that the frequent resort to advances from oil companies has been discontinued.
Nigeria	Account for the management of fiscal surplus does not exist. However, higher-than-budgeted oil revenues are set aside in a so-called excess proceeds account which are part of foreign exchange reserves. These accounts are drawn down on the basis of discretionary decisions by the executive.	Debt is not collateralized with oil revenue. However, the "ratchet effect" has led to accumulation of large debt both in years of low and high oil prices.

Sources: Country authorities; and IMF staff analyses.

In Cameroon and Nigeria, deposits in central banks serve in principle as instruments to stabilize the budget. In Chad and Equatorial Guinea, FFGs have been set up, which accordingly will not be available to finance government operations until oil revenues decline. Chad's FFG is to be managed by an international financial institution and invested in long-term financial assets. Under the staff-monitored program, the Congolese authorities have set up a special treasury account at the central bank to deposit excess oil revenue but have so far not made use of it. In contrast, despite higher-than-projected oil revenue, the government's net indebtedness to the central bank has continued to grow, reaching the limit set under BEAC policy. The Republic of Congo and Gabon have seen their contribution to BEAC foreign reserves diminish significantly in recent years.

C. Discussion and Recommendations

Participants acknowledged the trade-offs between, on the one hand, investing in financial assets or repaying debt and, on the other, investing in infrastructure and human development—including the political difficulties involved in generating a social consensus on the need to save oil revenues. As mentioned above, the need to accumulate financial assets for stabilization purposes is recognized, as is the need for investment in infrastructure and human development that would transfer wealth to future generations. Participants therefore viewed the financial savings option with some skepticism. They nevertheless acknowledged the constraints placed by poor institutional capacity on the identification and execution of high-quality projects. The strategy of saving on a temporary basis to accommodate absorptive capacity constraints was more easily accepted.

It will be important to continue the discussions on long-term sustainability and intergenerational equity issues. Depending on country circumstances, savings for future generations are in order, in particular in small countries with limited reserve outlooks and high oil revenue dependency. Even in cases where domestic absorptive capacity can be expanded sufficiently and government investment has demonstrably high rates of return, policymakers still have to discuss foreign exchange availability when the oil runs out, and they may come to the conclusion that some international savings are needed.