PAGE PARTNERSHIP FOR ACTION ON GREEN ECONOMY

Senegal

Managing Oil & Gas Revenues for Sustainable Development

BACKGROUND

Senegal is likely to become a significant oil and gas producer by the start of the next decade. The Sangomar oil field and Tortue-Teranga gas field are proven large-scale discoveries and are expected to begin production between 2021-2023. While these resources are not large by global standards, they can be an important driver of economic growth in Senegal both as the resource is developed and over the peak production period, which could last a decade or more. However, should Senegal becomes oil *dependent*, the foreign capital inflow associated with oil and gas production could cause serious macroeconomic challenges. Some types of funds and other institutional arrangements can help address these challenges, a number of which can encourage the government to use revenues for maximum public benefit. Several of these financial vehicles and mechanisms are discussed below, including policy options available to promote sustainable development.

- Managing fiscal revenues is one of any government's primary responsibilities, however non-renewable natural resource revenues have four special characteristics that constrain management choices or make certain choices more appropriate than others: 1) location specificity, 2) large and sudden rents, 3) volatility, and 4) finite nature. Should these revenues be large enough to cause economic challenges, there are several policy options available as follows.
- Macroeconomic management: in resource-rich countries, authorities can enact "fiscal rules" to promote fiscal sustainability (the ability to sustain current spending over the long term without defaulting) and smooth expenditures (delink volatile revenues from expenditures). Smoothing fiscal revenues in the short, medium and long terms may be the most important fiscal policy for Senegal as it starts producing oil and gas on a commercial scale. A fiscal rule—such as a limit on expenditure growth—might be appropriate since it can help constrain overspending and encourage more predictable year-to-year spending. Senegal is currently subject to the West African Economic and Monetary Union's balanced budget and debt rules, however these do not address the challenge of expenditure volatility.
- State-owned enterprises: most oil-producing countries have national oil companies, including Senegal (Petrosen). National oil companies' mandates are typically commercial, operational, regulatory, and/or developmental, and they often collect, manage, and reinvest petroleum revenues on behalf of the state. There are risks however, including inefficiency resulting in losses for the government; adoption of quasi-fiscal responsibilities to finance non-oil expenditures outside of normal budgetary procedures; accumulation of liabilities on behalf of the state; and excessive revenue retention. These risks can be addressed with legislation limiting revenue retention. Public oversight can be improved, for example by empowering an independent board or regulator.
- Distribution to subnational jurisdictions: in more than 30 countries, distribution of non-renewable resource revenues to subnational governments is governed by a distinct set of rules and formulae. Often, a portion of oil and gas revenues are transferred from the central government back to their area of origin. Such transfers can, however, create perverse incentives, exacerbating boom-bust cycles, regional inequalities, and violent conflicts at the local level. To prevent these challenges, governments have employed policies including easy-to-calculate formulae, consensus building, and strengthened transparency and oversight.

GOOD GOVERNANCE OF EXTRA-BUDGETARY FUNDS

- Many countries use extra-budgetary funds to manage their natural resource revenues. All but a handful of large oil producers have established a resource-financed special fund. Together, these funds manage trillions of dollars in resource revenues annually. In some cases, these funds are accounts within the state treasury, created for political purposes to demonstrate a commitment to financing a certain expenditure item or for accounting purposes. In others, they are institutions that are subject to different rules than the rest of the government's financial transactions.

This summary is based on the PAGE working paper (2018) 'Funds and mechanisms for the management of oil and gas revenues to support sustainable development: Insights from country experiences and lessons for Senegal', prepared by Andrew Bauer, Consultant on Public Finance.

- There are legitimate reasons why a government might establish an extra-budgetary fund, including that they can serve as multi-year funds, be used to earmark revenues for a specific purpose, or protect a stock of fiscal revenues from political interference.
- That said, there are several risks of such funds both in developing and advanced economies, including their ability to undermine public financial management systems and accountability, underachieve policy objectives, take excessive risks, charge high management fees, and enable patronage or corruption.
- Many of these risks can be addressed by sets of rules: management and organizational structure, inflow/deposit rules, outflow/withdrawal rules, investment rules, and transparency and oversight rules. In some cases international best practices exist (e.g. Santiago Principles, IMF's Guide on Resource Revenue Transparency, etc.), though decisions around the institutional structure and imposing certain sets of rules should be aligned with the fund's objective(s).
- Depending on the overriding objectives, there are a variety of different kinds of extra-budgetary funds to be considered, including sovereign wealth funds, strategic investment funds, development banks, earmarking funds, community development funds, corporate social responsibility-type funds, securities, closure funds, and rehabilitation funds.

MEASURES TO ADDRESS ENVIRONMENTAL AND SOCIAL IMPACTS

- Fiscal vehicles are not the only tools governments have at their disposal to address the environmental and social impacts of extractive activities. There are several other measures, including both those that can be implemented before a mining or petroleum project begins, as well as those that can be implemented while the mine or oil field is operating.
- Among these key measures are environmental and social impact assessments, compensation to local landowners, local content rules, shared-use infrastructure (e.g. electricity, water, housing, etc.), and mandatory and voluntary social contributions.

WAY FORWARD

There remains a great deal of uncertainty around Senegal's fiscal revenue and non-fiscal benefit potential from the oil and gas sector. Projects are still years away from completion, oil and gas prices may shift dramatically within the next few years and decades, and development and operational costs are unclear. Yet the Government of Senegal is in a position now to begin considering different policy options, with an eye to being ready once project details become better defined. While each presents an opportunity, each also comes with risks, though some are greater than others. The global experience with extra-budgetary funds and state-owned companies has been generally fraught with multiple challenges, especially when a separate large, bureaucratic institution is established. At the same time, special accounts within the national budget framework can certainly help address macroeconomic challenges and signal to the public that the government is committed to using its natural resource revenues for sustainable development.

Senegal could benefit from improved public financial management systems prior to the start of large-scale oil production in order to mitigate these risks. Independent public audits, improved parliamentary oversight, and enhanced internal budget controls are some of the possible reforms. Addressing these issues is critical for any financial vehicles or mechanisms to have transformative impacts on sustainable development. One recommendation would be for the government to systematically weigh the costs and benefits of each of these options prior to choosing one or several. This would involve cross-ministerial consultations, as well as discussion with cabinet members, parliament, and the public. The more evidence that is available to a wider spectrum of policymakers and engaged citizens, the more likely that the choices made will benefit Senegal as a whole.

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