Harnessing Oil Wealth in Guyana via a Sovereign Wealth Fund: Look Before You Leap♦

Asim Ali
Patrick J. Schena[1]

Introduction

Like other developing countries endowed with non-renewable natural resources but underdeveloped political economic institutions, Guyana, a new addition, will face similar challenges.[2]

Guyana is considering establishing a sovereign wealth fund (SWF) after Exxon-Mobil reported that a recent oil discovery off the coast of Guyana may hold up to 1.4m barrels of crude oil—worth between US$40-US$70bn. Guyana currently imports all of its gas and oil. The discovery of offshore deep-water oil reserves has the potential to bring a massive financial windfall to the country. Effective capture of these revenues is important for Guyana. This will require a national commitment to institutionalize the process and establish a clear mandate for the governance and management of these national assets. The risks of complacency include becoming a self-inflicted victim of "Dutch disease."[3]

Acknowledging that volatility, uncertainty, and exhaustibility of oil revenues complicate economic development and the execution of macroeconomic policy, US *Chargé d' Affaires* Terry Steers-Gonzalez encouraged the idea of a SWF for Guyana: "[R]evenues can be fleeting, whether coming in or going out. That is why the establishment of a comprehensive sovereign wealth fund is the cornerstone of, or crown jewel, in any new oil and gas regime. A sovereign wealth fund will provide Guyana with the opportunity to invest in its long-term future."[4]

Beyond capture, effective deployment of reserves built on excess oil revenues will be cause for considerable debate and require a national consensus to insure that oil streams, converted to

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♦ An abridged version of this article will appear in *The Harvard International Review* (Online Post).

[1] *Asim Ali* is a researcher and policy analyst at the The Fletcher Network for Sovereign Wealth and Global Capital, The Fletcher School, Tufts University. *Patrick Schena*, PhD, is Adjunct Assistant Professor at the Fletcher School, Senior Fellow and Co-Head of the SovereigNET: The Fletcher Network for Sovereign Wealth and Global Capital, The Fletcher School, Tufts University.

[2] "Guyana Strikes Oil: What the Windfall Means for the Country—and the Region," 2 February 2017, https://www.foreignaffairs.com/articles/guyana/2017-02-02/guyana-strikes-oil.

[3] Dutch disease, an affliction of the "resource curse" or "paradox of plenty," refers to the negative consequences of large increases in a country's income. The Dutch disease is the negative impacts on an economy of anything that increases inflows of foreign currency into the country, such as the discovery of large natural reserves. The currency inflows lead to currency appreciation, making the country's other products less price competitive on the export market.

[4] Remarks by Deputy Chief of Mission Terry Steers-Gonzalez at the Inaugural Guyana Oil and Gas Conference and Expo 2017. Accessible at: https://gy.usembassy.gov/remarks-deputy-chief-mission-terry-steers-gonzalez-inaugural-guyana-oil-gas-conference-expo-2017/

financial assets, are used in the best interest of the Guyanese people. This short note explores – with caveats - the scope of possible uses.

Political-Economics of Guyana: Reliance on Commodities

The Guyanese economy grew by an estimated 3% in 2015; it remains largely dependent on the export of a few commodities, including sugar and gold, which are vulnerable to adverse weather conditions and price fluctuations. According to the *Economist* GDP growth will accelerate, owing to gold mining, oil investments, and government spending.

With a windfall from oil-extraction, the Guyanese government is expected to increase infrastructure spending. Oil prices are, of course, sensitive to the vagaries of global markets. Price volatility and oil production lags will make the timing of oil revenue streams uncertain, and certainly not immediate. Nevertheless, the long-term consequences for Guyana—with a population of around 767,085 people (according to the latest World Bank figures) and estimated GDP per capita of US$4,127 in 2015 —will be transformative.[5]

Key facts about Guyana[6]	
Estimated recoverable barrels of oil equivalent	800 million to 1.4 billion
National population	767,095
GDP per capita, current USD	4127
Worldwide Governance Indicators Government effectiveness, global percentile	42
Worldwide Governance Indicators Rule of law, global percentile	36
Corruption Perceptions Index ranking out of 167 countries	119
Major exports	Sugar, gold, bauxite

Purpose of a Guyanese SWF: Development Objectives

With the obvious need for macroeconomic stability and long-term political, economic and developmental objectives, Guyana is prudent to create a fund to capture revenue streams in order to stabilize negative impacts from oil price volatility, while meeting unexpected liabilities and expenditures.[7]

Such a SWF would support macroeconomic stabilization and inter-generational equity through management of the income accrued from mineral and oil receipts. One of the main reasons for establishing a sovereign wealth fund is to ensure that income streams from oil revenues and

[5] "Large Oil Discovery Generates Hope, Challenges in Guyana," 29 November 2016, http://www.resourcegovernance.org/blog/large-oil-discovery-generates-hope-challenges-guyana

[6] Ibid.

[7] "Sovereign Wealth Fund will have effective budget stabilizing feature," 25 January 2017, https://guyaneseonline.wordpress.com/2017/01/25/guyana-sovereign-wealth-fund-will-have-effective-budget-stabilizing-feature-trotman/. Natural Resources Minister, Raphael Trotman noted: "One must first understand that the Sovereign Wealth Fund is just a generic name. Most funds of this kind have several features, which ours will have as well. However, the main characteristic of this Fund is to save money for the future generation which would be garnered from our oil wealth."

other mineral resources are managed so that they contribute to national development both presently and in future. The creation of a SWF will seek to address the negative effects on macroeconomic stability of a sudden large jump in income from hydrocarbons (and also "Dutch disease”). A key purpose of a fund would be to stabilize and smooth government revenue and expenditure over time to keep inflation in check and limit appreciation of the Guyanese currency.

Sovereign wealth funds frequently have twin roles in stabilization and savings, sometimes segregated into two sub-funds. In a savings fund, finance assets are locked away for the medium to long term with the aim of achieving inter-generational equity. A stabilization fund invests in shorter duration, liquid assets to insure that financial resources are available to meet immediate fiscal or monetary needs. A third mandate of increasing import to countries is to invest domestically in infrastructure and economic developments projects. These are also undertaken as sub-fund structures as in the case of Nigeria. While there is a great need in Guyana for investment in infrastructure in order to enhance sustained economic growth, extreme care must be taken in designing the governance of such mandates to avoid creating extra-budgetary streams that lack accountability in management and risk, accentuating – rather than alleviating – the very ails of the resource curse.

As discussions are underway regarding a Guyanese SWF, Guyana’s Natural Resources Minister noted the SWF would indeed have three sub-funds: 1) Stabilization Fund, 2) Infrastructure and Social Development Fund and 3) Citizens Participation Fund.[8] In terms of overall funding focus, the Minister noted: “Guyana is different from say Norway. Norway is a developed country. And so a lot of people say you have to look at Norway because they have the best fund in the world but countries like Guyana that suffer certain deficiencies are behind in terms of roads, airports, bridges, schools and so forth. So you will expect a little more of your money would be spent on those areas of infrastructure, education and health so that you can bring your people up to a better standard of living at a faster rate.”[9] However, for Guyana, the risks of inefficient investment in infrastructure – including politicization and even corruption - would mean that positive impacts of a development-oriented sub-fund would be undermined.

Ultimately, the utility of any SWF is determined by the suitability and effectiveness of its institutional role within a country’s broader macro-economic institutional order. For example, for resource or stabilization funds this includes integrating the operations of the fund into a well-functioning national fiscal framework, which might include a fiscal rule and specific benchmarks for allocation of oil revenues. For infrastructure funds, this includes aligning project investments with a national economic development agenda. By linking its fund to appropriate macroeconomic policies, insuring transparency in revenue flows, and instituting mechanisms for prevention of corruption and the application of international standards (e.g. environmental), Guyana will

[8] “Govt. fails to produce framework for Sovereign Wealth Fund in set time,” 28 December 2016, http://www.kaieteurnewsonline.com/2016/12/28/govt-fails-to-produce-framework-for-sovereign-wealth-fund-in-set-time/
[9] Ibid.

reduce the risks and challenges of poor implementation and more effectively exploit excess oil revenues to advance key national economic objectives.[10]

The Risks that Remain

The quiescent, but long-standing, territorial dispute between Guyana and Venezuela certainly increases the challenges of introducing a SWF to Guyana.[11] While flare-ups may have as much to do with Venezuelan domestic politics as with the oil exploration issue, a political-cum-economic framework between Guyana and Venezuela is necessary – perhaps with the support of regional partners - for long-term realization of oil windfalls.

Finally, despite the potential economic benefits that would flow from the introduction of a SWF, there remains the substantial risk that future Guyanese governments will use resources of the fund for short-term, political gain. Thus, while a SWF would provide a useful framework for capture and management of resource wealth, its impact is fully dependent on the commitment of future governments to elevate the fund and its mission above short-term political expediencies.

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[10] For example, Guyana has considered becoming a signatory to the Extractive Industries Transparency Initiative (EITI), a global accountability platform that mandates oil and mining companies to publish what they have paid governments – given Exxon Mobil, Chevron (US), Kosmos Energy (US), Hess (UK) and SBM Offshore (Netherlands) are all competing for business in Guyana's newly discovered oil sector and are a stakeholder in that country's long term development trajectory. Governments, in turn, publish how much they have received from oil companies. "Safeguarding against the "short stick" in oil and gas development," 26 January 2017, http://gina.gov.gy/safeguarding-against-the-short-stick-in-oil-and-gas-development/.

[11] "Guyana oil prospects stir friction between Venezuela and ExxonMobil," *The Financial Times*, 20 March 2017.