



CENTRE FOR POLICY ANALYSIS

**THE DILEMMA OF MACROECONOMIC POLICYMAKING:
“A TALE OF TWO CITIES”**

**STATEMENT DELIVERED BY
*THE EXECUTIVE DIRECTOR***

at the launch of

**CEPA ASSESSMENT AND CRITIQUE
OF THE
2009 BUDGET STATEMENT
AND
ECONOMIC POLICY
OF THE
GOVERNMENT OF GHANA**

*on
September 3, 2009
at
The British Council Hall, Accra*

Introduction and Background

The economic outcomes of the 2000 and 2008 election years bear several similarities. In particular, significantly large fiscal deficits were recorded in both years. These large fiscal deficits occurred on account of spending excesses that have become a characteristic feature of hotly contested presidential and parliamentary elections in the Fourth Republic of Ghana. Moreover, high private consumption and investment expenditures in these years — themselves election-induced — exacerbated the public spending excesses resulting in among others:

- accelerated depreciation of the cedi;
- rising inflationary expectations; and
- large depletions of international reserves.

There were important differences as well in terms of causes and severity. The crisis in 2000 was triggered by severe adverse price developments in the tradables sector in 1999. The rate of inflation reached 40 percent by year-end and in the foreign exchange market the cedi went into a free fall, losing half its value against the US dollar.

In contrast, the realized terms of trade were generally favourable to Ghana over the period preceding 2008. As the global financial crisis unfolded in the second half of the year, however, prices of the key export commodities, cocoa and gold, picked up and remained high in international commodity markets even as on the side of imports, the price of oil fell over the same period.

Thus, macroeconomic instability in election year 2008 was primarily due to election year spending excesses. The key difference was that the spending excesses of 2008 exacerbated a persistent trend deterioration of fiscal discipline noticeable from 2006 — what CEPA had described as a phenomenon of “*stubbornly high and widening fiscal deficits.*”

The World Bank Economic Governance and Poverty Reduction Credit (EGPRC) blame the Kufour Administration for the spending excesses that created the crisis:

*Lack of transparency and accountability has provided an enabling environment for the deterioration of fiscal management. The overshooting of the budget deficit went largely **unnoticed till late in 2008**. Indeed, poor access to information in a timely manner **prevented large deviations from planned expenditures being brought to the public eye, and even to the notice of political parties, International Financial Institutions (IFIs) and Development Partners (DPs)**. Transparency and accountability provide citizens with a means by which to be*

informed, to participate in public life in an informed manner and to pressure Government for improved outcomes. Without access to information, people lack the means to exercise the roles and rights that define citizenry and promote social accountability.....Some civil society organizations (CSOs) in Ghana have experience in conducting independent budget analysis, but their information basis has been weak. (emphasis added).

Moreover, in the campaigns promises were made where the objective reality called for stabilization.

The difficulties of the domestic situation are compounded by an extraordinarily challenging external environment. Additional foreign borrowing is excessively expensive and large foreign direct investment (FDI) unlikely. External demand for Ghana’s non-traditional exports and remittances are expected to suffer in 2009, as a result of the ongoing global recession. The World Bank classifies Ghana among the group of countries that are **most exposed to the global crisis** and with **the lowest fiscal room to cope**. (EGPRC, paragraph16, emphasis added). The World Bank therefore concludes that there is a strong macroeconomic rationale for providing swift counter-cyclical (to the global recession) external financing for Ghana.

In CEPA’s *Assessment and Critique of the 2009 Budget Statement and Economic Policy* — the document which is being launched today — it is contended that the economic program for 2009 presented to and approved by Parliament with its social democratic principles (and the explicit provision of GH¢42 million in support) was consistent with a strategy of **Growth with Macroeconomic Stability**. Paragraph 3 of the Letter of Development Policy to the President of the World Bank dated June 12, 2009 states:

The NDC Government in power is implementing a social democratic agenda to promote “A Better Ghana” in which real opportunities for gainful employment, prosperous enterprise and social and economic welfare of all our people are priorities. Government is taking actions to mitigate the global recession, stabilise the economy, safeguard the gains from growth and accelerate poverty reduction. (emphasis added)

A short piece “*Prudence can win*” in *The Economist* (May 30–June 5, 2009) cites the IMF as source for an explanation as to why, in spite of the global financial crisis, some African countries can, **even unaided** by the international donor community, **spend their way out of the looming recession**. Essentially the explanation is that “*with buoyant commodity prices in the boom, instead of overspending in good times some African countries, such as Tanzania and Mozambique, wisely built up their reserves. This is standing them in good stead now that the times are tough*”.

Unfortunately, Ghana is not in this privileged group.

Response of the BWIs — pro-cyclical stabilization program

In a letter of January 7 2009, the World Bank alerted the incoming Administration of the severity of the domestic financial crisis and hurried it “to request additional and extraordinary assistance from both the World Bank and the IMF.” The response of the World Bank was to reprocess its seventh Poverty Reduction Support Credit (PRSC-7) into the EGPRC — described as “*a more focused operation than the broader set of reforms supported by the Multi Donor Budget Support (MDBS)*”. (ibid paragraphs 49 and 50).

On the basis of the agreed institutional division of labour between the World Bank and the IMF, the IMF has the lead role in the area of macroeconomic policy and management. Its response was a programme under its Poverty Reduction and Growth Facility (PRGF).

Thus, in spite of its own admission of unpreparedness for the task, the World Bank has succeeded in mobilizing the IMF, the DPs and the new Mills Administration to convert a strategy of **Growth with Macroeconomic Stability** into following a strategy of “**a comprehensive program of macroeconomic stabilization and reform**” — **a Macroeconomic Stability with Growth** — over the three-year period July 2009-June 2012. (IMF: Attachment I, MEFP, paragraph 1)

Fiscal Policy

The Deficit and its Financing

In the stabilization programme with the Bretton Woods Institutions (BWIs), the target for the overall fiscal deficit is kept at the 9.4 percent of GDP in the 2009 budget and is an important conditionality dubbed a key quantitative performance criterion.

Any expenditure over-runs or domestic revenue shortfalls that would lead to an increase in the deficit must be adjusted for by “appropriate measures” agreed with the IMF to ensure that the targeted ceiling is respected.

The ceiling is also to be adjusted upward (downward) in the event that project loan disbursements are higher (lower) than programmed. This is to allow higher than anticipated disbursements of project loans to be spent and vice versa. The ceiling is to be adjusted downward (upward) by 50 percent of lower than programmed program loans (grants), up to a maximum adjustment of Ghana cedi equivalent of US\$75 million.

Illustration of Adjustment Measures

Data from the first quarter of 2009 suggest that with Treasury bill interest rates remaining high through May 2009, interest costs are projected to exceed earlier estimates for 2009 as a whole. To achieve the targeted fiscal deficit of 9.4 percent of GDP, additional fiscal savings totalling the equivalent of one percent of GDP (GH¢209 million) have had to be made. The key sources of savings are the following:

- the wage bill on account of the postponement of the implementation of the Single Spine Salary Structure for public sector workers, and a settlement with health sector workers lower than budgeted for;
- a reduction in the allocation for domestic investment spending — most likely from the GH¢42 million is placed in Contingency; and
- the passage into law of the National Stabilization Levy — an additional 5 percent profit tax — effective through end-2010 in selected sectors.

These corrective measures illustrate the types of adjustment measures that are required to be made whenever developments — such as expenditure overruns or revenue shortfalls — threaten to move the deficit above its targeted ceiling.

Financing the budget deficit

Resources for financing the deficit can conveniently be grouped into three categories namely:

- External private inflows of loans and equity;
- Net domestic financing (excluding borrowing from non-residents; does not differentiate between the purchases of non-residents and residents) in the domestic bond market; and
- Loans (project and programme) and debt relief from Development Partners.

Resources from the first category — the external private inflows of loans and equity — funded about 58.4 percent of the deficit in 2008. On account of the domestic and international financial crises, no resources are expected from these external sources of finance.

Domestic borrowing by government could lead to inflationary pressures if accommodated by increased supply of credit from the banking system. Ultimately, the government has the power to incur an unlimited deficit because it has the power to simply print up the money needed to buy back its own obligations. This course of action, however, is a cure that might well be worse than the disease. Indeed “rolling the printing press” has been described as the worst symptom of inflation. In the stabilization program, conditionalities are used to prevent such an occurrence.

Consistent with the stabilization programme, a tight ceiling has been placed on net domestic financing of the budget. The level of such financing has been reduced from the 6.7 percent of GDP projected in the 2009 Budget Statement to a maximum of 4.8 percent of GDP. Even with “updated projections for external disbursements” this resulted in a financing gap in an amount equivalent to US\$250 million.

This is expected to be covered by a Development Policy Loan from the World Bank “*which would augment planned World Bank support by US\$200 million in 2009, and by exceptional budget support from development partners.*” In the circumstances of the global recession, its dampening effect on growth and macroeconomic stability need for stimulus, in our view support for fiscal space is inadequate!

Expenditure Provisions

Given the tight planned budget deficit target of 9.4 percent of GDP **total expenditure (in terms of share of GDP) is projected to decline from 42 percent in 2008 to 36.6 in 2009 — a reduction of 5.4 percentage points** — essentially what is required to bring the deficit down from almost 15 percent of GDP to 9.4 percent of GDP.

The expenditure items whose outturns have been identified as critical to the overall outcome of the programme are the following:

- Public Sector Wage Bill;
- Energy Subsidies;
- Interest Payments and the Public Debt;
- Public Capital Expenditures (Item 4 and foreign-financed); and
- Poverty-related Expenditures.

Public Sector Wage Bill

The public sector wage bill has been a persistent source of budgetary over-run over the last decade or so. CEPA analysis locates the driving force behind the process in the social MDAs — health and education — which also are the largest. World Bank estimates show that in election year 2008, the wage bill increased by 38 percent, reflecting a 20 percent average wage increase — against average inflation of 15 percent — an 8 percent increase in staff strength, and 6 percent grade inflation — due to promotion.

World Bank staff computations also show that in the education sector, wages went up by 10 percent in real terms over the 2003-2008 period. Wages increased faster in the health sector over the same period. The World Bank further notes that Ghana’s pay structure is characterized by large inequities across sectors and by overall compression across skill levels. Moreover, its uncertain future evolution presents a risk to the ongoing fiscal consolidation process. Due to the nature of the collective bargaining process, the pay structure is also characterized by large inequities. These inequities are the result of, and are made worse by, the constant competition between different professions to move ahead and, consequently, of others to then catch up.

“The Government has implemented a net hiring freeze in the public sector (excluding the absorption of trainees in health and education — that normally constitute about 2 percent of public sector workers), until a medium term strategy to regain control over the payroll is in place. The expected outcome of the commitment to have this enforced is that at mid-year as well as end-year the number on the government payroll will be kept to a ceiling of 455,000 — the end-year total for 2008. Moreover, the budgetary provision is not to be exceeded. Not only is there no room for increase in the head count number on the payroll, grade inflation and average wage increases must be fully accommodated within the budgetary provision for Item 1. (EGPRC, Annex 4)

Energy subsidies

Subsidies paid for below-cost recovery tariffs and commercial losses to the energy sector absorbed over 1.0 percent of GDP in 2008. This was in spite of the relief to the financial crisis of the power sector, as a result of:

- good rainfall that enabled a big rise in hydro production;
- falling oil prices on world markets in the second half of the year; and
- a big tariff hike in November 2007 that improved the sector’s cash flow.

The Kufuor Administration added to the sector’s difficult financial position by its decision to resume operations at VALCO in the last quarter of 2008. VALCO profitability depended critically on the provision of subsidy in excess of US\$10/kWh — a burden that was placed on VRA (2009 Budget, paragraph 435). Operations have been suspended since January 2009. VALCO is an important industry and its long-term prospects and viability need to be carefully examined prior to a final decision on its future. Such a review has been scheduled for 2010.

In 2009, a favourable generation mix — more hydro and less thermal production — continuing lower oil prices, and the closure of VALCO are expected “*to bring the subsidies needed to cover VRA’s current operations to zero*”. Government, however, “*will still need to fund both VRA and ECG investment expenditure and long-term debt servicing*” (EGPRC, paragraph 99).

Interest Payments and the Public Debt

Higher than projected rate of inflation, Treasury bill rates, and exchange rate depreciation have resulted in an upward revision of interest payments for 2009. Preliminary analysis of debt sustainability suggests that debt distress indicators could remain in the moderate range and that with decent rates of economic growth and fiscal discipline the net public debt could stabilize at around 50 percent of GDP over the medium- to long-term.

Non-concessional borrowing of US\$750 million was contracted in 2007. In 2008, the Government contracted five new non-concessional loans, for a total amount equivalent to US\$585 million. The main factor driving the decision to borrow on non-concessional basis in 2008 was the need to continue ongoing public investment projects in **key sectors, notably in the energy and water and sanitation** sectors. From World Bank reports, however, value for money considerations and implications for the public debt and debt service were not fully taken account of at the time. Consequently, rates of return of these projects and impact on debt sustainability are now being assessed on a case by case basis.

Public Capital Expenditures

An important imbalance that needs correction in order to give greater weight to growth and poverty reduction is the preponderant and rising share of recurrent expenditure. In this regard the tendency to reduce domestically financed capital expenditures as an easy way to keep to the overall fiscal deficit ceiling is extremely worrisome. Moreover, the World Bank’s EGPRC document refers to “continued

compressed investments” in 2010 among measures expected to “generate the additional fiscal adjustment targeted” (EGPRC, paragraph 27).

A point of concern for the growth objective is the constant reference to the existence of ‘non-development’ or ‘low priority’ projects. This provides a convenient rationale for cutbacks in development and infrastructural spending as an adjustment measure without examining the consequences in terms of potential output and job losses. Like the ‘ghosts’ said to exist on the government pay rolls, non-development or low priority projects have no place in the budget given the acknowledged large inadequacies in infrastructure, particularly in the energy, roads, water and sanitation sub-sectors.

The IMF has also drawn attention to the phenomenon of increasing rigidities in the budget and the severe limitations thus placed on room for policy manoeuvring. They ascribe these rigidities partly to the existence of a number of statutory funds into which transfers are made in accordance with existing statutes, and committed expenditure items determined by contracts and agreements with Development Partners (referred in the budget as foreign-financed capital expenditure).

Statutory Funds

Transfers into statutory funds — the District Assemblies Common Fund (DACF), Ghana Education Trust Fund (GETF), Road Fund (RF) — together, are projected to increase by 33 percent over the total provisional outturn of 2008. The planned schedule of arrears clearance this year also includes an amount for DACF in respect of the fourth quarter of 2008, and a similar amount for the GETF in respect of November 2008 arrears. Sizeable resources are therefore earmarked for unspecified expenditure at a time when higher priority expenditures are unfunded and therefore not implemented. Moreover, the share of transfers into these funds — already high — appears set to increase further this year. The government is committed to a review of the legal provisions and management of some of these statutory funds, with the view to introducing greater flexibility and efficiency in overall fiscal management.

Foreign-financed Expenditures

Foreign-financing of public capital expenditure comes from two sources: project grants and project loans. Total disbursements of project grants is projected to increase by 70.1 percent above the 2008 level, while total disbursements of project loans is projected to increase by 53.9 percent in 2009. Thus, total foreign financing of capital expenditures is planned to increase by 61 percent in a context where the domestically

financed counterpart continues to be reduced. The sharp increase in donor-dependence and the dominance of donor preferences in public capital expenditures in 2009 and beyond are obvious.

Undoing the rigidities and inflexibilities so as to unlock resources, prioritizing and phasing of projects, insisting on value for money and generally improving the quality and efficiency in public capital expenditures would enhance economic growth for the same capital expenditure. According to the World Bank’s EGPRC document:

The Government, through the newly appointed Economic Advisory Council, is starting a review of public expenditures to inform prioritization, benefiting from the deep knowledge of sectors working groups comprising line ministries and DPs.

CEPA strongly urges that this is treated with utmost urgency so as to be relevant this year.

Pro-poor Expenditure

The impact of the current macroeconomic difficulties and global recession in Ghana comes at a time when many of the poor have not yet recovered from the impact of a series of shocks, starting with floods and drought in the North during 2007 and to the food and fuel crisis during 2008.

The 2009 budget raised the share of pro-poor expenditures over the provisions of 2008 — albeit only marginally. In real terms, however, the allocation in 2009 falls considerably short — by about 5 percent — of that of the previous year.

The government has also committed itself to prepare an options paper that includes recommendations on ensuring the financial sustainability and protection of the poor under the NHIS reform (universal coverage, one-time payments etc). This is expected to pave the way for the reform of the NHIS with a focus on sustainability, equity, and effectiveness.

It has been observed that the recent past has seen a quick, but somewhat uncoordinated expansion of social protection initiatives. The system now entails a number of small-scale efforts that need to be evaluated before further scaling up, and that also need to be better coordinated. It is proposed to rely more on targeted transfers to households (a combination of means-tested and geographically targeted).

Targeting has posed particularly difficult challenges, with a number of interventions presented as social protection programs but whose impact and effectiveness are not known. The World Bank contends that in the present fiscal environment, it is important to evaluate the impact of programs such as the school feeding program and the National Youth Employment Programme (NYEP), in order to assess whether programs tagged as ‘pro-poor’ are indeed having the desired effect.

Monetary Policy

The Record of Performance

The overall record of monetary policy performance over the last three years has been weak, but that in 2008 in respect of the disinflation objective was particularly disappointing. In budget 2008 the Bank of Ghana (BoG) was expected to direct monetary policy towards reducing the end-period inflation to a target range of 6-8 percent at year-end and further down to a range of 4-6 percent by end-2009. As it turned out, the set target for 2008 was missed — in fact, overshoot by a significant margin.

Given the experience of persistent overshooting of inflation targets, the assessment of CEPA has been that with no change in the monetary policy framework and target setting, the target for 2009 would prove unrealistic and go the way of its predecessors — missed by considerable margins. It was therefore not surprising — indeed, somewhat a validation — when the target for 2009 was revised upwards from 12.5 percent to 14.6 percent. In CEPA’s view, even this upward revision is likely to prove extremely costly to achieve.

In its July deliberations, the Monetary Policy Committee (MPC) of the Bank of Ghana (BoG) had indications from its Composite Index of Economic Activity (CIEA) and elsewhere that the economy was slowing down rapidly — implying potential output and job losses. Consequently, in spite of the inflation rate remaining above the projected path, it concluded that the prime rate should be kept unchanged at 18.5 percent, for the reason that “*the risks in the outlook for disinflation and growth are balanced*” (paragraph 49, MPC Press Release, July 21 2009, p. 18).

Consultation Mechanism on Inflation

The stabilization programme also includes a consultation mechanism on inflation. The BWIs contend that “there is a need for close monitoring, given the context of an uncertain global environment”. The

consultation mechanism on inflation involves quarterly reviews for 2009 followed by semi-annual reviews starting in 2010.

Inner and outer bands have been constructed around a central inflation target for the end of each quarter — i.e., \pm two percentage points for the inner band and \pm three percentage points for the outer band — starting from September 2009. Whenever the realized year-on-year inflation rate falls outside the specified band this would trigger consultation with the IMF.

The Government of Ghana (GoG) is obliged to complete consultation with the Executive Board of the IMF on the proposed policy response (which will also be announced to the public) before requesting further disbursements under the stabilization programme when the year-on-year inflation rate moves outside the outer band — more than three percentage points higher or lower. The GoG “*will not be able to request any further disbursement under the PRGF arrangement if the inflation rate moves outside the outer band until the consultation with the Executive Board of the IMF has taken place*”. The GoG is also obliged to conduct discussions with the IMF staff when the observed year-on-year inflation rate falls outside the inner band specified for the end of the quarter under review. (IMF: Attachment II, MEFP, paragraph 13).

CEPA forecasts of the inflation rate have so far proved accurate. The forecast for June 2009 was marginally lower than realized while that for July was marginally higher. The forecast for September 2009 is 20.5 percent. The central target is 16.5 percent with an inner band upper limit of 18.5 percent and an outer band upper limit of 19.5 percent. Thus, should the CEPA forecast for September prove as accurate as those in the earlier months, the Government of Ghana would be obliged to immediately enter into and complete consultation with the Executive Board of the IMF on an appropriate policy response — most likely an interest rate hike — failing which there would be no further disbursement under the stabilization programme.

Trade-offs

A simulation exercise conducted and published by the IMF, based on its model of the Ghanaian economy, showed that to achieve the inflation target of 2008 the real GDP growth rate for 2008 would have had to slow down to as low as 4 percent per annum. In the current stabilization programme, the projected real GDP growth is marginally higher at 4.5 percent per annum. In the event of further worsening in the global

environment, the World Bank staff project a lower growth scenario in which real GDP grows at a low rate of about 2 percent per annum — negative in per capita terms — for 2009.

The implications of these magnitudes of slowdown in terms of output losses, jobs and poverty **need to be carefully analyzed**. CEPA’s fear in all of this is how **to ensure that the poor are not used as cannon fodder in the war on inflation**.

All too often, as the international evidence has shown, it is the poor and politically voiceless who bear the brunt the most. In the current democratic environment, therefore, **the policy response required in an inflation consultation mechanism should have been made in conscious recognition of the trade-off and the consequences for unemployment and poverty**.

Critique of the Inflation Targeting Framework

Early inflation targeting (IT) strategy put heavy emphasis on achieving annual reductions in the inflation rate on schedule, as a way to establish central bank commitment to price stability. This is particularly so where monetary policy credibility has been badly eroded by high and persistent inflation as in the current situation in Ghana.

The evidence, however, shows that the focus on hitting short-run targets sooner than later would run into difficulties, largely because of lags in the policy transmission mechanism. The effects of forceful policy reactions would stretch beyond their intended short-run purpose, pushing inflation to the other side of the target range and requiring actions to reverse it.

A lesson from the experience is that a modern approach to IT should be more flexible and forward-looking as well as providing better communication. Credibility is not helped by policy actions that attempt to keep inflation within a target range every single year. A central bank can strengthen its credibility by openly focusing its policy on more than just hitting annual targets, recognizing that its actions involve short-run trade-offs and being mindful of undesired effects on output and employment (IMF: “Inflation Forecast Targeting in a low income country: The Case of Ghana” paragraph 12, page5 in Country Report No. 08/332, October 2008).

The recommended modern approach emphasizes longer-term results. Under this framework, the Bank of Ghana would publish regular monetary policy reports that contain its forecast for inflation, associated macroeconomic variables, and at least a qualitative indication of the likely course of the policy interest

rate — the prime rate. **Each of the elements of this flexible approach requires that the Bank of Ghana has a realistic, coherent model of the monetary policy process, from policy instruments to objectives.**

Clearly, a solid forecasting model is an essential element of this approach. The point to emphasize, however, is that the Bank of Ghana is yet to move its policymaking framework from the so-called “standard model” to a more appropriate and flexible one. According to the IMF, “*the standard model.... is less appropriate for (a developing country in a disinflation phase like) Ghana.*” (ibid, paragraph 14; emphasis added).

It would appear, however, that neither the IMF nor the Bank of Ghana has anything beyond the standard model to guide the inflation consultation mechanism! The mechanism has all the flaws raised in the critique of the current BoG IT framework!!

Exchange Rate Developments

Official Exchange Rate

In public discussions in Ghana, the cedi-to-US dollar exchange rate has been the official rate often quoted, even though other bilateral rates such as the cedi-to-pound sterling and cedi-to-euro exchange rates have featured in Ghana’s international transactions with the rest of the world.

The Nominal Effective Exchange Rate Index

Using the official cedi-to-US dollar exchange rate to judge the competitiveness or otherwise of domestic exchange rate policy, however, could be misleading. This is because a depreciation of the Ghanaian cedi against the US dollar, for example, could very well be on account of an appreciation of the dollar against any one of the other major currencies such as the pound sterling or the euro. Indeed, such could be the case while the cedi is appreciating against some major currencies as happened with the pound sterling for most part of the first half of 2009.

To overcome this problem, an appropriately weighted index, referred to in the literature as the *nominal effective exchange rate* (NEER), is often used.

The Question of Weights

The NEER is typically constructed as a weighted summary index of the bilateral exchange rate indices of the cedi with respect to the topmost currencies traded on domestic foreign exchange markets — the US dollar, the pound sterling and the euro in the case of Ghana. Two versions of this summary index — the currency of transactions-weighted and the trade-weighted — are often constructed depending on the expected use or uses of the index.

The first measure is typically the preferred choice of most central banks (including the Bank of Ghana) interested in monitoring developments in the foreign exchange markets on account of inflows and outflows into these markets; the second measure, the direction of trade-weighted NEER, is more oriented towards assessing the role of trade in the overall growth of an economy.

Using the trade-weighted NEER, CEPA observed a steady pattern of nominal depreciation of the exchange rate over the period from the last quarter of 2007 up to the first quarter of 2009 — reflecting a steady weakening of the domestic currency on the foreign exchange markets.

Similarly, to compare performance of the Ghana cedi in the first and second quarters of this year, the MPC of the BoG in its July Press Release used the currency of transactions version of the NEER — that preferred by the BoG — to conclude that: *“In the foreign exchange market, there was a relative slowdown in the depreciation of the cedi against the three core currencies in the second quarter of the year”* (paragraph 23). CEPA computations are consistent with this finding.

Competitiveness Index

Another equally important summary measure of the performance of the exchange rate is the ***real effective exchange rate (REER)*** index — one of the key measures of a country’s international price competitiveness. This is on account of its taking into consideration relative production costs between Ghana and trading-partner countries. It is constructed by adjusting the NEER for relative inflation differentials between Ghana and trading partner-countries.

Trend appreciations of the real effective exchange rate are considered unfavourable for domestic tradables. It reflects the fact that domestic costs of producing tradable goods are increasing relatively faster than the price in cedis — inclusive of depreciation of the nominal exchange rate. This could squeeze profitability and profits of exporters and import-competing enterprises and, in extreme cases —

as with the current global recession — lead to labour cutbacks, enterprise shutdowns and loss of market shares at home (for import-competing enterprises) and abroad (for exporters).

Over the past five years, Ghana’s non-traditional exports have been losing market shares in global commodity markets primarily because of an overvalued currency not compensated for in terms of productivity gains and other incentives. This trend has continued into 2009 even though the recent depreciation partly corrected the earlier overvaluation.

Given the current global recession, innovative ways (including by enterprises and public procurement policies) need to be found to support the non-traditional export sector to make it more competitive. Ghanaians, especially in the private sector, must move quickly to exploit the global knowledge revolution and make effective use of information and communications technology (ICT) in the quest to transform the agricultural, industrial and services sectors of the economy. Government policy must also be directed at attacking the infrastructural and financial bottlenecks that make doing business and producing goods in Ghana costly.

Near-Term Outlook for Inflation and Poverty

Inflation Outlook

CEPA review of performance record over the last four years and analysis of the monetary policymaking framework led to the conclusion that the year-on-year inflation target of 12.5 percent for December 2009 was over-optimistic and that like its predecessors would be missed by a considerable margin. This view was affirmed in the stabilization program which revised upward the end-December 2009 target to 14.6 percent — an increase of 2.1 percentage points. In CEPA’s view the targets set in the stabilization program are ambitious and would prove difficult to achieve given what could be high though, alas, not quantified socio-political cost in terms of output and job losses, and the additional poverty burden that would be placed on those least able to bear it — namely the already-poor.

The table below shows the quarterly targets together with the CEPA forecasts for 2009. In comparison with the program target of 19.7 percent set for June, the CEPA forecast was 20.6 percent — marginally lower than the 20.7 percent recorded. Consequently, the target for June was missed by a full percentage point.

| INFLATION TARGETS AND FORECAST FOR 2009 | | | |
|--|-------------------------|-------------|------------|
| | (Year-On -Year) | | |
| | June¹ | Sept | Dec |
| CEPA Forecast | 20.6 | 20.5 | 20.9 |
| IMF (Central Inflation Target) | 19.7 | 16.5 | 14.6 |
| GSS (Actual Inflation) | 20.7 | n/a | n/a |

Outlook for Poverty

The available evidence points to a slow-down in the tempo of economic activity and the continued increase in income poverty indicators. In the EGPRC document the World Bank notes that:

The impact of the current macroeconomic difficulties in Ghana comes at a time when many of the poor have not yet recovered from the impact of a series of shocks starting with floods and drought in the North during 2007, and to the food and fuel crisis during 2008.

In 2004, the National Health Insurance Scheme (NHIS) was launched to replace the system of user fees, which was seen as creating financial barriers to accessing health care. However, the staff of the

World Bank has drawn attention to the existence of several challenges to the scheme:

- the NHIS is not adequately reaching the poor and informal sector;
- the current claims reimbursement mechanism and increased utilization are escalating health care costs and constraining supply;
- the administration and organizational structure of the insurance program has led to delays in reimbursing claims by health care providers; and
- the political pressure to expand the scope of the NHIS without adequate preparation could potentially threaten its financial sustainability.

The urban poverty rate is estimated to have increased by between 1 to 3 percentage points. Moreover, income poverty could rise further this year and the next, as per capita private consumption growth is expected to fall. The planned macroeconomic adjustment entails increased cost

recovery in the energy and utilities’ sectors and increased taxation as a result of which real per capita private consumption growth would fall. This will result in income poverty rising by as much as 2 percentage points — an additional 500,000 people below the poverty line, on optimistic assumptions of an income distribution skewed against the poor.

¹ The actual year-on-year rate of inflation for July 2009 is 20.5 percent as compared with CEPA forecast of 20.6 percent.

Conclusions

The G20 Summit

The G20 Summit of April 2, 2009 made recommendations for the BWIs to create new instruments and to **mobilize the requisite resources (including from the sale of part of the gold holdings of the IMF) to help developing countries to provide the necessary economic stimulus and thus to spend their way out of the looming recession caused by the international financial crisis and global recession.**

The hopes of the G20 summit are not reflected in the kind of support Ghana received from the stabilization package agreed with the BWIs.

In 2001, significant debt cancellation, debt relief and the democracy dividend “*provided the country with the required fiscal space to embark on critical infrastructure investments, particularly in the energy and road sectors, as well as targeted social spending*” (IMF: Attachment I, MEFP, paragraph 3). That financial crisis of 2000 was a lot more severe and therefore the case for a stabilization package was evidently stronger than in the current crisis.

“Prudence can win”

As noted earlier in *The Economist* of May 30 to June 5 2009, there are some African countries like Tanzania and Mozambique, that had wisely built up their reserves and therefore could, even unaided by the international donor community, avoid the adverse impact of the global recession. Alas, Ghana is not one such country.

Response of BWIs

The response of the BWIs to Ghana is the stabilization program. Its selling points are to:

- have an important signalling effect;
- strongly contribute to stabilizing the financial and foreign exchange markets; and
- serve as a partial bridge to the onset of oil production, expected to start in the last quarter of 2010.

The stabilization programme reportedly had the important signalling effect. The evidence points to improved fortunes of Ghana’s Eurobond, floated since 2007 on international financial markets. CEPA analysis also supports the view that nominal depreciation of the cedi slowed down in the second quarter of 2009 compared to the first quarter.

Risks to the Stabilization Programme

Significant risks to the stabilization program have been identified. The key ones are (paragraph 140 of the EGPRC document):

- There are potential downside risks from the global recession, with implications for GDP growth, macroeconomic stability and financing prospects (from public and private creditors) for Ghana.
- There are also political feasibility risks to the fiscal adjustment.

“The lack of transparency and accountability prevented large deviations from planned expenditures being brought to the public eye, and even to the notice of political parties.”

This may explain the reported phenomenon of extensive campaign promises. Consequently, the 2008 elections were contested generally on *“an electoral platform emphasizing the need to improve and broaden public services, at a time of fiscal stabilization requirements”* (ibid; paragraph 67, emphasis added).

- Budget execution risks are considerable.
“In 2009, the reduction of investment expenditures, the containment of the public sector wage bill and other recurrent expenditures (energy-related subsidies), additional grants and low oil prices will largely contribute to reduce the deficit.” Should any one of these risks materialize and not be mitigated as envisaged, additional fiscal adjustment would be needed, most likely through greater compression of domestically financed investment.
- Energy-related risks of various types including the hydro-thermal mix, higher oil prices on world markets than budgeted, and lower rains expected, inducing resort to higher subsidies to the energy sector to cover thermal generation costs.

The Stiglitz Critique

CEPA had emphasized in its flagship publication of 2006 — *Ghana Macroeconomic Review and Outlook, 2006 (pages 22-23)* — the overriding need for the recognition of some of the long-standing principles of successful economic policymaking and implementation: namely, participation, ownership, and the role of economic advisors — the Stiglitz Critique. Specifically, these are that:

- there are trade-offs (between macroeconomic stability and short-run economic growth rate);

- there is uncertainty in the dynamics of any economy and therefore about the consequences of any policy;
- different policies affect different groups differently (in dimensions of poverty, gender and geography);
- the role of the economic adviser (such as the BWIs) is to inform policymakers of the consequences of different alternatives; and
- it is the role of the political leadership to make decisions on these alternatives (represented by credible structures for policymaking involving the Executive and Parliament).

Stiglitz further noted that the BWIs have been instrumental in perpetuating the myth that in economic policymaking there is always a single “dominant” policy and which is therefore “optimal”. Another myth is that “economic policy is apolitical”. These institutions are “not supposed to enter into political matters (though they do so regularly and inevitably)”. And as if to rationalise such unwarranted intrusive behaviour, “they refer to the member governments as their shareholders, suggesting that they are more akin to corporations than to political institutions”.

The CEPA Position

The position of CEPA is that were the socio-political costs of stabilization — in terms of poverty and social distress — properly assessed and taken fully into account (as they should have been) in the design of the stabilization programme, other combinations of macroeconomic stability and short-run growth rates would have been found that could prove to be socio-politically preferable. The choice of this belongs to the government — which must own the development strategy — particularly in a fragile democratic polity like Ghana. Without ownership, it is difficult to mobilize the political will needed for successful implementation. As the World Bank itself has stressed (EGPRC paragraph 55): “*The criticality of Ghana’s ownership is a lesson to be drawn from past development policy operations.*”

One such possible combination of short-run economic growth and macroeconomic stability — which admittedly would call for more resources from the international donor community, together with greater growth-enhancement and efficiency in public expenditures than in the stabilization package — would keep real economic growth close to the 5.9 percent target in the 2009 Budget Statement, albeit with an end-year inflation target higher at about 20 percent. That is more in line with the **Economic Growth with Macroeconomic Stability** strategy discernible in the *2009 Budget Statement and Economic Policy*.