



**CENTRE FOR POLICY ANALYSIS**

# **GHANA MACROECONOMIC REVIEW**

*Special Feature on  
Basic and Secondary Education*

**2000**

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## 1. EXECUTIVE SUMMARY

Anti-inflation stance as a basis for restoring sustainable macroeconomic stability assumed center stage in official government policy making from the end of 1995 when the year-on-year inflation reached 71 percent. Fiscal prudence constituted an important component of the policy package with the money supply expected to serve as a nominal anchor against inflation. In particular, the requisite monetary restraint was to be achieved through the generation of budgetary surpluses enough to provide resources for lending to the private sector. In short, the success of the anti-inflationary programme rested squarely on increased government savings on a sustainable basis.

The record shows that the projected budgetary surpluses have not materialised. The hoped-for complementarity between fiscal and monetary policies has remained elusive mainly due to failure to cultivate a culture of sustained internalised fiscal discipline. In the event the chosen policy menus have deviated markedly from the intended and have led to difficulties in accessing credit and high cost of credit for business. In the last few years' fiscal indiscipline also resulted in severe crowding out of the private sector through the accumulation of payment arrears and non-payment of bills to businesses and individuals for goods and services supplied to government (even if ironically others received payment for no work done).

Far from moving towards total elimination of the perennial fiscal imbalances by the end of 2001 as recommended at the 1997 National Economic Forum (NEF), the fiscal position has rather systematically deteriorated. Budgetary imbalances have become entrenched and have been the primary cause of the resurgence of macroeconomic instability. In the last two years (1999 & 2000) the deterioration in the fiscal stance was amplified by adverse terms of trade shocks and delays in aid disbursements as a result of non-observance of poverty reduction and growth facility (PRGF) conditionalities agreed with the IMF. Bank of Ghana's attempts to meet monetary targets often resulted in the bouncing of government cheques and a build-up of domestic payment arrears. The consequential proxy borrowing by government led to a sharp build-up of banking sector claims on the private sector as private sector operatives turned to the banking system for accommodation on account of locked-up working capital in spite of the onerous interest rates.

In recent times, the central government's fiscal deficit has been financed using some combination of four instruments, namely:

- proceeds from sale of government assets (divestiture);
- net borrowing from abroad (largely aid flows);
- net official borrowing from the domestic economy — the domestic public sector borrowing requirement (PSBR); and
- non-payment for goods and services rendered (arrears or unofficial borrowing)

Continued dwindling of the aid pipeline, disbursement delays, and implementation difficulties encountered by the divestiture programme deepened government's reliance on domestic sources to finance the large budgetary deficits.

Net foreign financing declined from 2.6 percent of GDP in 1998 to 0.9 percent of GDP in 1999 and in year 2000 debt repayments exceeded new loan disbursements in spite of over \$20 million of external payment arrears. Correspondingly, net domestic financing, including CEPA's estimate of the domestic payment arrears, rose from 5 percent of GDP in 1998 to 7 percent of GDP in 1999 and sharply to 10.3 percent of GDP in 2000. Consequently, government domestic borrowing as a share of the total financing required rose from 61.5 percent in 1998 to 85.7 in 1999 and then to nearly 90 percent for the 2000 fiscal year.

Interest on the national debt (domestic and foreign) regained its importance as the largest single item of government expenditure in fiscal year 2000 — constituting over 40 percent of total recurrent expenditures. The payments of 7.5 percent of GDP exceeded the previous record high of 6.1 percent of GDP for the 1998 fiscal year. The relative moderation in interest payments in 1999 of 5.4 percent of GDP was achieved not only as a result of the decline in the interest rates on Treasury bills but also due to postponed external debt service payments.

Contrary to the popular misconception that domestic borrowing by government was essentially in respect of domestic interest payments, the available data indicates that domestic interest payments were equivalent to 78 percent of domestic borrowing in 1999 and an even lower 60.3 percent in year 2000. In general the amount of domestic borrowing is determined by a

combination of factors: the size of the budget deficit, net foreign financing, the treatment of divestiture and other capital receipts, and the extent of hidden liabilities incurred by government.

In addition to the large outstanding stock of the official domestic debt, there are also payment arrears owed to suppliers of goods and services to government, including road contractors. The size of this unofficial debt has been growing rapidly in recent years. And yet no serious attempts have been made to get some accurate measure of the stock of these arrears. The stock needs to be properly audited, clarified and included in the official stock for a more rationalized policy on the domestic debt issue. CEPA has estimated that the payments arrears stock at the end of 2000 was equivalent to 4.1 percent of GDP. Rather distressingly, the interest burden on the Budget does not show any signs of abating. These developments call for a proper and coherent policy on debt management.

For the year 2000, as in the year before, the quest for price stability and arrest of the fast depreciating cedi were the main objectives of monetary policy. The Bank of Ghana instituted restrictive monetary policy with interest rate as the main instrument, complemented by an increase in the primary reserve requirement from 8 to 9 percent of deposits, and the enforcement of financial regulations, particularly those relating to dealings in foreign exchange.

As with other election years (1992 and 1996) the fiscal pressures were overbearing in 2000 for the monetary authorities, particularly following closely on the worst macroeconomic crisis Ghana has witnessed in recent times. Although the central bank continued to give the impression of a tough stance against government fiscal excesses through the dishonouring of government cheques, the year turned out to be one of massive monetary accommodation. The Government depleted its deposits at the central bank from 875 billion cedis at the beginning of the year to a zero balance by the end of July, and then the Bank of Ghana commenced the extension of overdraft to the Government. By the end of the year, a total overdraft of about 900 billion had been extended to the Government. This caused the monetary authorities to renege on their commitment to the IMF limiting them to a domestic financing of no more than 254 billion cedis. Significantly, the country had in June 2000 asked for a waiver from the IMF for tripping

this very “performance criterion” at the close of the preceding year. In effect, the Bank of Ghana “printed” money to finance the fiscal deficit.

The impact of the monetary accommodation on *reserve money* (liquid liabilities of the central bank) was to push it to 2,150 billion cedis – about 17 percent above target. This compares unfavourably with the 1 billion cedis excess the year before for which the country had to ask for a waiver. An examination of available data from the Bank of Ghana reveals that control was lost on the reserve money target in the last quarter of the year 2000. Year-on-year, reserve money increased by about 35 percent, with potentially serious inflationary consequences.

Growth in the stock of money for the year 2000 was a reflection of the expansionary fiscal policy and the liberal accommodation by the monetary authorities. Money supply increased by about 40 percent over the year, negating previous attempts at tight money during the early half of the year. Claims by the banking system on government more than doubled from about 2.1 trillion cedis at the beginning of the year to 4.6 trillion at the end of December 2000. But much of the increase was in the second half of the year, leading one to speculate on election pressures. There was also a large increase (74%) in credit to the private sector during the year. This, as CEPA has pointed out in earlier reviews, may be indicative of increased borrowings by the sector on account of high costs of forex due to the fast depreciation of the cedi, as well as continued “proxy borrowing” by Government in respect of new arrears being generated in the system.

Most banks in Ghana showed impressive performance for 2000, even as the national economy tottered. Huge borrowing by government and the consequent high Treasury bill rates provided lucrative investment avenue for the banks. Nine out of the 14 banks existing in 1999 made over 100 percent gains in profit-after-tax by the close of 2000. Of the remaining banks, apart from the Merchant Bank (Ghana) Limited, all made modest gains over their previous year’s profit-after-tax.

Although the banking industry on the whole appears healthy the rise in the non-performing loans to total loans ratio gives cause for worry. The worsening of this solvency index has necessitated a huge provision for bad debt by the two biggest banks – Ghana Commercial Bank and the

Standard Chartered Bank. This poor situation is not unrelated to the debt of the Tema Oil Refinery (TOR).

For the year 2000, “bad” lending to the Tema Oil Refinery took a big toll on the Standard Chartered Bank and the Ghana Commercial Bank, as these banks were forced to make huge “provisions for bad debts”. As a result, Standard Chartered lost its place in the first position as the best performing bank. GCB, however, in spite of the huge provision managed to climb to first position on the back of “small” clients. As the former threw away small customers, the latter picked and nurtured them with small “guaranteed” facilities. Workers who manage to get guarantees from their work places are offered easy personal loans by GCB. Recovery on these loans is virtually 100 percent. Small can, indeed, be beautiful.

Another big income earner for the banks was “commission and fees”, representing charges of various kinds that are imposed on clients. Such charges include penalties for having account balances below the stipulated minimum, charges for processing loans and advances, as well as charges for other bank services such as processing of bank drafts.

In CEPA’s view the fiscal targets set in the ESAF programme are unrealistically tight. However, as long as the Bank of Ghana retains discretionary authority over the monetary and public finance uses of the Treasury bills and bonds, it can impose whatever fiscal discipline it needs for the attainment of its monetary stance by simply refusing to pay government bills. The sustainability of this process depends on both internal and external borrowing options available to private suppliers of goods and services to government. Such suppliers are currently saddled with mounting claims (payment arrears) on government.

Ghana’s external payments position deteriorated sharply in year 2000 with an overall balance of payments deficit on official settlements of US\$221 million and gross international reserves of less than one month of import cover. Coupled with this is a rising external debt service ratio of 23.4 percent of GDP.

In the foreign exchange market, the deterioration in external payments and the accompanying

controls resulted in shifting foreign exchange operations into the parallel market, increasing stocks or pipeline of foreign exchange applications in the deposit money banks (DMBs), and a sharp depreciation of the exchange rate. The nominal exchange rate depreciated by 96.8 percent on a year-on-year basis in 2000, following upon an equally sharp depreciation of 49.2 percent in 1999.

Policy responses to the crisis were ad hoc and ineffective, in part on account of a wrong diagnosis of the nature of the crisis. For most policy makers in Ghana, the external shock was perceived as transitory and therefore required only financing. Their preferred policy choice was controls and attempts to smoothen out the shock even with depleted reserves. By November 1999, it was clear that the external shock was a permanent one and could therefore not be accommodated by temporary controls and swap arrangements. Yet, this was precisely the response of Ghanaian policy makers. In November, the monetary authorities introduced special swaps targeted at the net foreign assets of the banking system for which a waiver had to be granted by the Fund on account of its multiple currency practice implications.

A direct consequence, however, of the terms of trade shock on the fundamental determinants of the equilibrium exchange rate was to cause it to depreciate. Consequently, even if by the end of December 1999 the previous misalignment had been fully corrected for, the new market equilibrium rate was once more misaligned vis-à-vis the terms of trade affected equilibrium rate.

The preferred policy option of the Fund appeared to be either a package including devaluation or resort to the automatic adjustment mechanism. Under sticky prices, the latter must first result in overshooting before an eventual equilibrium is attained. Moreover, the cost of relying on such a mechanism in the face of depleted international reserves could be heavy to the nation in terms of growth and employment in the economy.

The external payments position of the country in year 2000 was one of the worst in recent times. Against the backdrop of very low levels of international reserves, huge trade and current accounts deficits, and declining long and medium term official and private capital net inflows, the overall balance of payments situation worsened for the second consecutive year.

On an official settlements basis, Ghana's overall balance of payments position deteriorated sharply in 2000 compared to the three years preceding it. The overall balance of payments deficit (official settlements basis) worsened from US\$156 million – the equivalent of 1.2 percent of GDP – at the end of 1999 to US\$221 million or 3.6 percent of GDP at the end of 2000. These deficits contrast with overall balance of payments surpluses amounting to 0.4 percent of GDP and 1.3 percent of GDP in 1997 and 1998 respectively.

The performance of non-traditional exports in 2000 was sluggish and disappointing. Marketing strategies may still be poor and possibly lacking the dynamism required in competitive markets. Major exporters in the sector continue to complain about high utility tariff rates and high costs of domestic bank credits. There are also concerns raised in connection with the financing and promotion of non-traditional exports in Ghana – the Ghana Export Promotion Council that was set up almost three decades ago to be responsible for this, receives limited financing from government.

The contribution of all other exports – largely diamonds, bauxite, manganese, residual oils and electricity – was a little more than in 1999. This contrasts with the decline in share in respect of cocoa beans and products. The share of the earnings of this group of export commodities in the total rose from 28.4 percent in 1999 to 30.6 percent in 2000. However, mineral ores other than gold (diamonds, bauxite and manganese) contributed less than one percent of export revenues in 2000.

Confusing signals continued to pervade the external debt service payments position of the country in year 2000. In an earlier edition of its *Macroeconomic Review and Outlook*, CEPA had noted serious problems at reconciling data on the country's external debt stock as published by the Bank of Ghana on the one hand, and that published by the International Monetary Fund on the other. These problems seemed to have persisted into 2000, with potentially damaging consequences.

In an Aide-Memoir dated November 21 2000, the Fund expressed dismay and lack of credibility in the Ghanaian Monetary Authorities for providing what it referred to as ‘incorrect’ data on the country’s external debt payments. It noted among other things that:

*“The Mission was unable to obtain basic historical data to verify whether 2000 debt payments were current. All indications suggest that external arrears have persisted through November 2000.”*

It went on:

*“The Mission found that the information provided to the Fund before the August 2000 Executive Board Meeting was incomplete. First, the staff was led to believe that the proceeds from the sale of Ghana Telecom shares that were to be received in July were high enough to assure program financing. Secondly, the staff was told that Ghana was current on its payment of external debt service at the time of the Board meeting. Both these statements proved to be incorrect.”*

These observations are quite serious, coming in a context in which Ghana has a three-year Poverty Reduction and Growth Facility (PRGF) Arrangement with the Fund expected to remain operational up to May 2, 2002. They also raise serious questions about what the true external debt stock position of the country is. Any useful debt sustainability analysis will require that the true position is known.

It is now estimated that Ghana had accumulated US\$68 million arrears in 1999 and a further US\$21 million in 2000, bringing the total outstanding external arrears at the beginning of 2001 to US\$89.0 million. It would appear that the larger accumulation of 1999 was with the knowledge of the Fund. It can be readily recalled that in the fourth quarter of 1999 the cedi depreciated sharply as the terms of trade shock impacted and reserves fell sharply.

Official statistics on Ghana’s external debt stock – reportedly revised in the course of a debt sustainability analysis (DSA) by the Fund – increased by 2 percent from US\$5833 million at the end of 1999 to US\$5947 million at the end of 2000.

The increase in Ghana's external debt stock in 2000 was largely on account of increased net borrowing from bilateral sources. While multilateral lending on a net basis remained unchanged, borrowing from bilateral sources increased by 4.8 percent from US\$1840 million in 1999 to US\$1929 million in 2000, marginally raising its share to 32.4 percent of the total debt stock.

### ***The Social Sector: Basic and Secondary Education***

Economic progress or development is measured not only using per capita growth rates but also by what happens to indicators such as the adult literacy rate, infant and child mortality rates, the proportion of children who are stunted or wasted etc. These are indicators that capture aspects of the individual's well being. Improvements in these indicators are important guidelines of the goal to reduce poverty. It is recognised that improving upon the education and health of individuals not only has an intrinsic value for the individual, but in the appropriate setting can increase their income-generating capacities and consequently their choice sets.

Several studies on the determinants of poverty in Ghana have found that the education of the household head and of the members of the household is a significant determinant of poverty. Education is a means of lifting an individual and household out of poverty. The benefits of education and good health are not limited to the individual. Society also benefits from an educated and healthy populace. Social sector policies therefore form an important and integral part of any country's development strategy.

In recent months developments in the education and health sectors have formed the topic of most public debates. In the education sector there is concern about the quality of education and the glaring and unacceptable differences between rural and urban schools. Education funding is still a very sensitive issue at the tertiary level.

The current reforms in the basic education sector are being implemented under the umbrella of the Basic Education Sector Improvement Programme (popularly known as fCUBE). The fCUBE programme has three components. These are improving the quality of education, improving the quality of education management and improving access to basic education. There needs to be more commitment and greater effort in ensuring that these components of the programme are

implemented. It must also be realised that the three components are interrelated. Access to education will not be improved if the children are not provided with quality education. Improving the quality of education management is critical to ensuring that there is quality education.

The rate of increase in enrolment was higher for girls than boys between 1998/99 and 1999/2000 academic years. This suggests that progress is being made in closing the gender gap at the basic education level. Two caveats though are in order. The first is that girls' enrolment rates are still significantly lower than boys in many regions. The second caveat is the worrying phenomena of the decline in the enrolment of boys in some regions and a fall in the number of boys that sat for the BECE in 2000. Thus in some locations the closure of the gender gap is because of falling enrolment amongst boys. The reasons for the declining enrolment of boys need to be understood and policies introduced as soon as possible to address the situation.

The quality of education in primary school as measured by performance in the Criterion Referenced Tests is low. Test scores have been improving since 1992 but are still very low. The better performance of private school pupils compared to public school pupils suggests that school quality has a heavy weight amongst the factors explaining performance in the examination. Injecting more resources into the primary education sector is not the only solution to dealing with the issue of poor school quality. Other factors are critical in ensuring an improvement in primary school quality. The first is the quality of the teaching staff. Whether teachers have attended teacher training college and the quality of teacher education are important factors in influencing the capacity of teachers to understand the curriculum and deliver it in the classroom in a format that will be comprehended by the pupils. Other variables that affect school quality are the availability of teaching and learning materials, the organization and management of the school and the extent of teacher supervision. Greater participation of parents and guardians in the management of the schools could also improve upon monitoring of and use of resources available to the schools.

Improving upon the quality of education requires that there is an effective monitoring system. The BECE provides an excellent opportunity to monitor the output of the junior secondary

schools. However the choice of the Stanine system for evaluation of examination has made it impossible to utilise the examination for this purpose. This is because the Stanine system does not use objective criteria to assess performance. A candidate's grade is assessed on the basis of the performance of the set of candidates that sat the examination and not in relation to independent criteria or benchmarks. It is recommended that the marking system of the BECE be reviewed so that the examination can be used for monitoring purposes.

At the primary, junior secondary and senior secondary levels there is clear evidence of inequality in the education system. The locational inequalities as reflected in regional differences in the performance in examination are stark. The regional differences in examination performance that is evident at all levels of the education ladder are indicative of regional differences in school quality. Migration to areas with higher school quality is a likely response to this phenomenon. Not all people born in regions with comparatively lower levels of education can migrate or else send their children to live with relations or friends in other regions and districts. It is imperative that measures are implemented to ensure a standardization of good quality basic education in all districts and localities of the country. Failure to do this can hinder other programmes and projects that are being implemented to address the problem of uneven regional development and poverty in the country.

## 2. REVIEW OF PUBLIC FINANCE AND FISCAL OPERATIONS

### 2.1 Introduction

Anti-inflation stance as a basis for restoring sustainable macroeconomic stability assumed center stage in official government policy making from the end of 1995 when the year-on-year inflation reached 71 percent. Fiscal prudence constituted an important component of the policy package with the money supply expected to serve as a nominal anchor against inflation. In particular, the requisite monetary restraint was to be achieved through the generation of budgetary surpluses enough to provide resources for lending to the private sector. In short, the success of the anti-inflationary programme rested squarely on increased government savings on a sustainable basis.

The record shows that the projected budgetary surpluses have not materialised. The hoped-for complementarity between fiscal and monetary policies has remained elusive mainly due to failure to cultivate a culture of sustained internalised fiscal discipline. In the event the chosen policy menus have deviated markedly from the intended and have led to difficulties in accessing credit and high cost of credit for business. In the last few years, fiscal indiscipline also resulted in severe crowding out of the private sector through the accumulation of payment arrears and non-payment of bills to businesses and individuals for goods and services supplied to government (even if ironically others received payment for no work done).

Far from moving towards total elimination of the perennial fiscal imbalances by the end of 2001 as recommended at the 1997 National Economic Forum (NEF), the fiscal position has rather systematically deteriorated. Budgetary imbalances have become entrenched and have been the primary cause of the resurgence of macroeconomic instability. In the last two years (1999 & 2000) the deterioration in the fiscal stance was amplified by adverse terms of trade shocks and delays in aid disbursements as a result of non-observance of poverty reduction and growth facility (PRGF) conditionalities agreed with the IMF. Bank of Ghana attempts to meet monetary targets often resulted in the bouncing of government cheques and a build-up of domestic payment arrears. The consequential proxy borrowing by government led to a sharp build-up of banking

sector claims on the private sector as private sector operatives turned to the banking system for accommodation on account of locked-up working capital in spite of the onerous interest rates.

## **2.2 Overall Assessment of the Fiscal Stance**

### **2.2.1 Basis for Assessment**

Assessment of the fiscal stance is only meaningful when it is based on commitments data. In spite of official acknowledgement of payment arrears in the current period, no decisive effort is being made to come to grips with the problem and official assessment of fiscal performance continues to be judged on payment basis. Moreover, in situations where most projects are on going and pre-financed — as is often the case in road construction — a cash-basis measure of the fiscal stance will almost certainly prove inappropriate.

Clearance of road sector arrears in 1999 and 2000 amounted to ₵53 billion and ₵328 billion, while non-road related clearance for the two years amounted to ₵77 billion and ₵156 billion, respectively. Distressingly, the problem of arrears accumulation remains an on-going process that affects more than the development budget. New road arrears of ₵196 billion were reported in 2000. CEPA estimates also show that at least ₵115 billion of non-statutory arrears unrelated to the road sector were newly accumulated in 2000. The case of statutory arrears in relation to government's contribution to the Social Security Fund in its capacity as employer and transfers into the District Assemblies Common Fund (DACF) is even more disturbing. The latter was reportedly in arrears of two and half quarters for the 2000 fiscal year. And the indications are that the problem is yet to see a satisfactory resolution in spite of commitments to the IMF.

Except for a few cases, notably the statutory payments, — personal emoluments, social security contributions of government as employer, and transfers to the District Assemblies — it has not been possible for estimates of payments arrears to be made for individual expenditure items. Using supplementary data including from the banking system, however, CEPA has been able to make reasonable estimates of the build-up of the stock of arrears over time. Thus, while some of the individual expenditure items are presented on a payments basis using the official statistics, a correction is made for the total expenditure to bring it to commitments basis as required for a

meaningful assessment of fiscal stance.

### 2.2.2 Measures of Assessment

It has been the tradition at CEPA to use different measures of the fiscal stance in order to separate out the effects of different components of fiscal pressure. Because these measures focus on different aspects of the issue they do not, in general, point in the same direction. Consequently, information from all such measures requires careful analysis before forming judgements about the state of the government's fiscal operations. What remains true, however, is that when all the measures point in the same direction they reinforce each other and serve to clarify the state of affairs.

#### 2.2.2.1 The Domestic Primary Balance

In recognition of the continued inability to control the size of the interest on the national debt, the erratic and inconsistent nature of divestiture receipts, and the uncertainties surrounding disbursements of foreign grants, the domestic primary balance (DPB) has become the key measure of fiscal performance in IMF-supported programmes with Ghana.

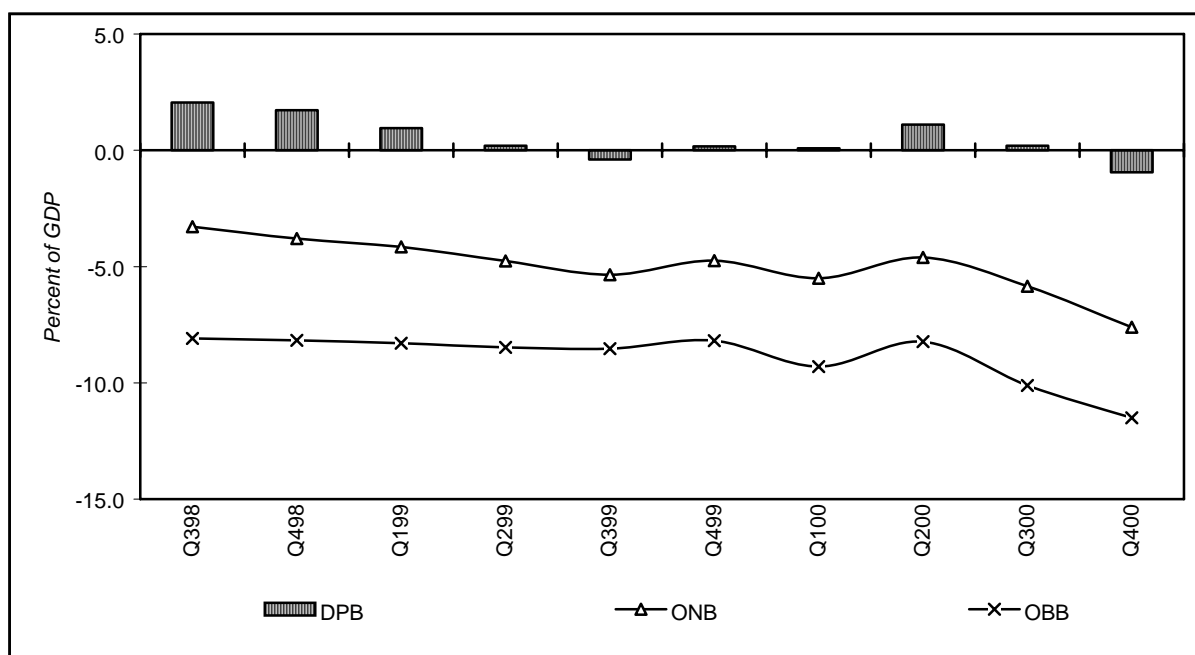
	1998	1999	Q100	Q200	Q300	2000
Domestic Primary Balance (DBP)	1.7	0.2	0.1	1.1	0.2	-0.9
Overall Narrow Balance (ONB)	-3.8	-4.7	-5.5	-4.6	-5.8	-7.6
Overall Broad Balance (OBB)	-8.2	-8.2	-9.3	-8.2	-10.1	-11.5
<i>Memorandum Items</i>						
Programme Grants	0.5	0.5	0.3	0.5	1.0	0.9
Interest Payments	6.1	5.4	5.9	6.2	7.1	7.5
** Assessment is on commitments basis						
Source: BOG, Ministry of Finance, and CEPA Staff Estimates						

The DBP is the balance of the difference between domestic current revenues (tax and non-tax) and total non-debt domestic expenditures. In excluding debt service charges and volatile flows of both external (aid flows) and internal (capital receipts like divestiture) origin, the DPB is a good

gauge of the fundamentals of the fiscal situation. In addition, the DPB provides a measure of the current fiscal effort since the excluded debt service payments are predetermined by the size of previous deficits.

If the DPB is in deficit, it signals a potentially unsustainable process of indebtedness. This is because, barring foreign grants, maturing loans and interest payments have to be paid by further borrowing. In the process, additional interest accrues and the debt problem threatens to get out hand. If the ratio of debt to national income is to decline and stabilize at a sustainable level, then the DPB must, at the minimum, show sustainable surpluses<sup>1</sup>.

**Figure 2.1: Aggregate Fiscal Performance Indicators**



The performance of the DPB for the three-year period 1998-2000 is presented in Table 2.1. Also, established trends since the third quarter of 1998 are graphically depicted in Figure 2.1. The general picture is one of deterioration with an apparent slight improvement in the second quarter of year 2000 when a surplus equivalent to 1.1 percent of GDP was achieved. The relatively better

<sup>1</sup> When nominal interest rates on government debt do not exceed nominal GDP growth, then a DPB surplus will imply a falling government debt/GDP ratio.

performance was on account of improvement in tax collections by the VAT Secretariat and the IRS. It also reflects compliance with IMF demands to postpone expenditures amounting to at least 1.0 percent of GDP until the second half of 2000. According to the IMF these expenditures, if necessary, would be eliminated entirely should fiscal developments at the end of the first half of 2000 prove less favourable than programmed.<sup>2</sup> In the event there was a sharp deterioration in the second half of 2000, which resulted in a DPB deficit equivalent to 0.9 percent of GDP for the fiscal year.

Compliance with IMF demands provided the illusion of fiscal improvement since, as discussed in Section 2.7.4, it only increased the stock of payments arrears. Given the intense pressures of an election year, the arrears could not be sustained leading to deficit financing.

Adequacy of the DPB is viewed against the debt service obligations. A positive DPB, which is less than the debt service due could, in the absence of IMF or other restraints on domestic financing of the deficit, crowd-out the private sector in domestic capital markets. The situation is obviously worse when the DPB is negative as in fiscal 2000.

Because of the poor performance of aid disbursements including programme grants, not much reliance could be placed on aid for relief. Thus for 1998 and 1999, these grants have been no more than 0.5 percent of GDP. The 2000 performance of 0.9 percent of GDP, although a slight improvement over the established trend, was nonetheless inadequate. To put the matter into perspective, it may be noted, by way of comparison and contrast that interest payments, after declining from 6.1 percent of GDP in fiscal 1998 to 5.4 percent of GDP in fiscal 1999, increased sharply in 2000 and reached a high of 7.5 percent of GDP.

#### *2.2.2.2 The Overall Narrow Balance*

In assessing the fiscal stance the overall narrow balance (ONB) formalizes the above discussion by taking into account actual inflows of foreign programme grants and interest payments due. The ONB, as currently measured, is a good indicator of the domestic public sector borrowing requirement (PSBR).

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<sup>2</sup> Memorandum of Economic and Financial Policies (MEFP) of the Government of Ghana, 2000, par. 33.

Given the relatively low levels of programme grants — arising from delays and lags in aid disbursements — and the rapidly escalating debt service obligations, the ONB has shown a general tendency to deteriorate. As shown in Table 2.1, the out-turn for fiscal 1998 was a deficit equivalent to 3.8 percent of GDP. This widened to 4.7 percent of GDP for 1999 and further deteriorated to 7.6 percent of GDP in year 2000.

### 2.2.2.3 *The Overall Broad Balance*

The overall broad balance (OBB) includes, on the receipts side, all domestic current revenues as well as inflows of foreign grants —both programme and project. On the expenditure side it includes all domestic expenditures as well as aid-financed expenditures — both capital and current.

In order to illustrate the complementarities in the three measures of fiscal stance it is useful to establish their relationships. These can be derived from equations (1), (2), (3) and (4) of Box 3.1.

The expenditure monitoring and control system of the government has proven incapable of providing credible estimates of foreign-financed expenditures on a commitments basis. The working assumption is to use receipts of project loans and grants disbursed as proxy for expenditures paid for. Delays and cancellations of aid flows, however, have often made it necessary for contractors and the government to pre-finance expenditures in respect of on-going projects, or even on new projects started in expectation of planned disbursements. And the CEPA methodology for estimating payments arrears does not make it possible to fully disaggregate and assign to each and every specific item of expenditure.

On a payments basis, the absolute difference between the OBB and the ONB is receipts of project loans disbursed in the fiscal year. In other words the OBB is wider than the ONB by the extent of fiscal expenditures financed with aid projects loans disbursed.

**Box 2.1 Measures of the Fiscal Stance: Inter-Relationships**

Let  $DR$  = domestic revenue (tax and non-tax) excluding divestiture receipts  
 $DNDE$  = domestic non-debt expenditures  
 $ProjG$  = project grants  
 $ProgG$  = programme grants  
 $INT$  = interest payments on the national debt  
 $ProjL$  = project loans  
 $FFC$  = foreign-financed capital projects

Then

$$DPB = DR - DNDE \quad (1)$$

$$ONB = (DR - DNDE) + (ProgG - INT) \quad (2)$$

$$OBB = (DR - DNDE) + (ProgG - INT) + (ProjG - FFC) \quad (3)$$

$$= ONB + (ProjG - FFC)$$

$$= ONB + (ProjG - ProjL) \quad \text{since } FFC = ProjG + ProjL$$

$$= ONB - ProjL \quad (3)$$

$$= DPB + (ProgG - INT - ProjL) \quad (4)$$

If foreign-financed capital is exclusively from grants then  $OBB = ONB$ . However, if  $FFC$  is partially financed from grants, then  $OBB = ONB - ProjL$ . The NEF recommendation of a balanced budget in the broad sense thus requires that the surplus harnessed from the narrow balance is at least equal to the amount of project loans expected to flow into the country during the fiscal year.

To the extent that the sum of project loans and programme loans exceed scheduled amortisation — i.e. when net foreign inflows is positively in our favour — then a zero  $OBB$  balance would make it possible for the entire net foreign inflow to be channelled through the domestic banking system for unending to the private sector and/or reduce the size of the domestic debt..

The amount to be financed when the overall broad budget is in balance is zero. Net external financing is defined as

$$\text{Net External Financing} = ProjL + ProjL - \text{Amortisation} \quad (5)$$

Current government policy is earmark proceeds from divestiture for domestic debt reduction. This means that the sum of domestic financing and foreign financing of the budget must necessarily be zero when the budget is in balance. It thus follows that net domestic financing of the budget in a context of a broad balanced budget — and when all divestiture and other capital receipts are exclusively devoted to paring back the domestic debt — must satisfy the identity

$$\text{Net Domestic Borrowing} = - (ProjL + ProjL - \text{Amortisation}) \quad (6)$$

Again, on payments basis the absolute difference between the  $OBB$  and  $DPB$  is the sum of project loan receipts and debt service payments, less programme grants. Conceptually, grants can exceed the total of project loans and debt service payments due. Indeed there are countries in sub-Saharan Africa for which this is the case. In Ghana's case, however, this has never been so and in fact in recent years programme grants have been far short of debt service payments. The result has been  $OBB$  outcomes — measured as ratios to GDP — wider than the  $DPB$  in orders of magnitude approximated by the sum of project loan disbursements and debt service payments.

**Box 2.2 The 1997 National Economic Forum (NEF) and the Budget**

*In 1997 a National Economic Forum (NEF) was held to look at the policy options that would propel the country forward. Among other things, the NEF had to confront the challenge that, the Constitutional provisions for central bank independence notwithstanding, monetary policy had tended to be lax and accommodative of the rather expansionary fiscal regime. Against this background the NEF concluded that there was a need for a clear national commitment to a balanced budget — where the measure of the budgetary stance was the all-encompassing overall broad balance (OBB). A target of a balanced broad budget was set for the year 2001. Additionally, guidelines were also provided for the path — i.e. the yearly benchmarks — towards the attainment of the ultimate zero balance objective.*

*The balanced budget objective set by the NEF was more than a matter of fiscal prudence. It also recognised the low savings rate of the Ghanaian economy that had resulted in a yawning gap between the investment requirements — public and private — and the resources available for funding. Relatedly, low domestic savings had contributed to aid-dependence, which over time, had made Ghana a highly indebted country.*

*The NEF recommendation carries several important implications:*

- *First, in a world characterised by shrinking aid pipelines especially of grants, it requires the generation of enough domestic primary surpluses to service the domestic and foreign debt.*
- *There is also the stark reality that sub-Saharan African countries have not been major recipients of the large foreign direct investment (FDI) flows around the world. A second implication of the NEF recommendation is that it opens up the possibility of using the state to mobilise external resources to be re-channelled through the domestic financial institutions to fund private sector investment. Such an outcome would allow for a rapid release of domestic credit to the private sector — the so-called crowding in of the private sector. Given the dearth of domestic saving and the perennial large savings/investment gap, this can be quite strategic in furtherance of the private-sector led market-friendly policy.*
- *Finally, given the low level of international reserves and the conventional guideline of at least 4 months import cover, a zero balance, or better still a surplus, would free a substantial part or all of the project and programme loans from donors into the building of reserves.*

As noted above, foreign-financed expenditures are treated as self-financing — with receipts being equated to expenditures incurred. Treated this way — which is by no means satisfactory — the size of foreign-financed expenditure, although important in terms of both its economic significance for investment and in the calculation of the OBB as a measure of the fiscal stance, nonetheless does not constitute a source of domestic borrowing pressure.

Moreover, the Ghanaian experience shows considerable volatility in foreign-financed expenditures on account of bureaucratic procedures in aid agencies. Also, in recent years the volatility has been affected by disbursement interruptions resulting from difficulties in observing the conditionalities agreed with the IMF and the World Bank as well as bilateral donors.<sup>3</sup> For a heavily aid-dependent economy, this volatility could be destabilising if reflected in erratic public

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*3 In 1999 \$50 million of Japanese aid was unexpectedly cancelled because of perceived increased likelihood that Ghana might wish to avail herself of the Highly Indebted Poor Country (HIPC) Initiative.*

investments. Delays and cancellations in disbursements would also show in the official budgetary statistics in erratic behaviour of the OBB. For example, low disbursements of project loans would be equated to low foreign-financed development expenditure and, therefore, a correspondingly low OBB.

As has been explained earlier, improvements in any one particular measure of the fiscal stance could prove illusory. Thus on a commitments basis, the volatility in flows could lead to a rising stock of payments arrears where contractors on projects pre-finance expenditures. It could create added domestic borrowing pressure where the government is forced to meet its contractual obligations to its suppliers of goods and services by borrowing in domestic markets. Consequently, in practice, the spending and financing mismatch can and does create domestic borrowing pressure. It has also been pointed out that in the exceptional cases where the uncertainties in aid inflows actually reflect in volatility in public investments, future growth and employment prospects could be adversely affected.

As with the other measures of the fiscal stance already discussed, the OBB has also shown a tendency to worsen. With the caveat concerning data availability on externally financed expenditures only on payments basis, the generally deteriorating trend of the OBB deepened in fiscal year 2000 reflecting the fact that over 75 percent of the financing package came from project loans, up from an average of 65 percent in the previous two years.

***Box 2.3: The Extent of Ghana's Aid Dependence***

Of increasing concern to CEPA is Ghana's growing dependence on foreign aid. This manifests itself in increasing external indebtedness, debt service (both interest and principal repayments), and reliance on aid for public investment and imports. In spite of the reported delays in the disbursements of external aid, the share of public sector investment projects financed by donor resources increased from 58 percent in 1996 to a peak of 84.4 percent in 1998 before dropping to about 74 percent in 1999 and 53 percent in 2000 (Table B2.3a).

**Table B2.3a: Indicators of Ghana's External Dependence**

	1996	1997	1998	1999	2000
Central Govt. Development Budget					
% Domestically-Financed	42.0	37.0	15.6	26.3	46.7
% Foreign Financed	58.0	63.0	84.4	73.7	53.4
<i>Foreign Debt Service</i>					
%GDP	5.5	5.0	4.2	4.8	4.6
%Tax Revenue	33.5	34.0	28	34.5	31.1

Foreign debt servicing obligations also continue to put a strain on the nation's resources — raising questions in some circles about Ghana's withdrawal from the HIPC Initiative in the past. On average, about 5 percent of national income was used to repay principal and interest on foreign loans between 1996 and end-June 2000. In terms of fiscal pressure about one third of the tax collections was spent on payment of foreign interest and principal during the same period.

Judged from another perspective, the donor component of ex-ante budgeted discretionary expenditures (excluding public safety) increased from an average of 33.3% in 1999 to 42.3% in 2000 (see Table B3.3b). For all categories except the social services, the annual Budget Statements to Parliament projected proportionately higher donor funding in 2000 compared to 1999.

**Table B3.3b: Donor Component of Budgeted Discretionary Expenditures**

% of Total Discretionary Expenditure	1999	2000
General Administration	25.2	52.4
Economic Services	57.7	61.6
Infrastructure	55.1	71.6
Social Services	16.8	7.2
<b>Total (excluding Public Safety)</b>	<b>33.3</b>	<b>42.3</b>

Source: Based on data from 1999 and 2000 Annual Budget Statements

In the area of General Administration, the budgeted donor content of discretionary expenditures for the Ministry of Local Government and Rural Development, Office of Parliament, and General Government Services for the year 2000 all exceeded 60% with that of the Office of Parliament being 82%. For Economic Services, budgeted donor support for the Ministries of Food and Agriculture, Mines and Energy, Trade and Industry, and Environment Science and Technology all exceeded 60 percent of the total for 2000 fiscal year. Finally, in the area of Infrastructure, budgeted donor support as percent of total discretionary expenditure for the Ministry of Roads and Transport increased from 50% in 1999 to 76% in 2000 while for the Ministry of Works and Housing the donor dependence dropped slightly from 70% in 1999 to 64% in 2000.

Notwithstanding the technicalities of the pre-financing implications for arrears, the key

observation from the trajectory of the OBB is the widening divergence from the NEF recommendation of eliminating this deficit by the end of year 2001 (see Box 2.2). The deficit has shown a clear tendency to widen steadily. From 8.2 percent of GDP for 1998 and 1999, it deteriorated to an estimated 11.5 percent of GDP for fiscal 2000. (See Table 2.1).

### **2.3 The Budget and Ghana's Aid Dependence**

Data weaknesses notwithstanding, the OBB, as measured, also brings home the high aid dependence of the Ghanaian economy. For example, the foreign-financed capital spending of the Government (payment basis) has been at least 5.0 percent of GDP for the three-year period 1998-2000 (see Table 2.7). In terms of shares, the foreign-financed component of central government's development budget<sup>4</sup> has ranged from 71.6 percent to 79 percent between the first quarter of 1999 through the second first half of 2000 with an average share of 75 percent of GDP. The corresponding proportion for the 1998 fiscal year was even higher at 84.4 percent of GDP. The 53.4 percent share for the 2000 fiscal year is a reflection of the disbursement snags experienced during the year. The issue of Ghana's aid dependence is discussed in Box 2.3.

### **2.4 Financing of Government Fiscal Operations**

In recent times, the central government's fiscal deficit has been financed using some combination of four instruments, namely:

- Proceeds from sale of government assets (divestiture);
- Net borrowing from abroad (largely aid flows);
- Net official borrowing from the domestic economy — the domestic public sector borrowing requirement (PSBR); and
- Non-payment for goods and services rendered (arrears or unofficial borrowing)

Continued dwindling of the aid pipeline, disbursement delays, and implementation difficulties

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<sup>4</sup> The central government's development expenditure, as defined here, excludes the transfers into the District Assemblies Common Fund (DACF), the Education Trust Fund, and the Road Fund.

encountered by the divestiture programme deepened government's reliance on domestic sources to finance the large budgetary deficits.

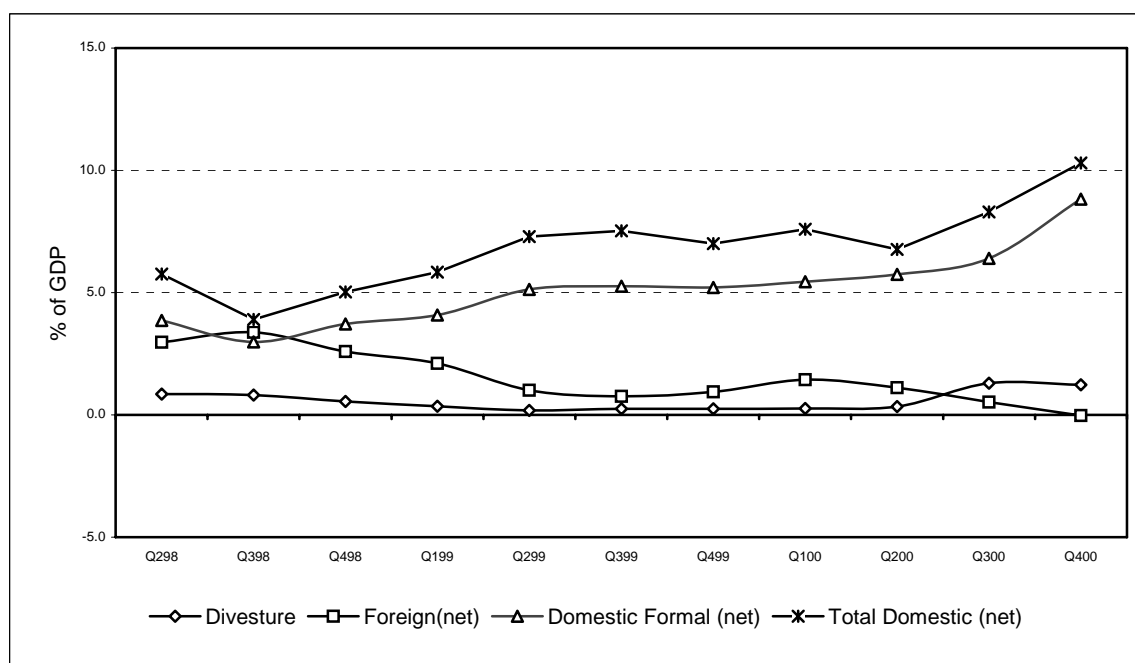
	1998	1999	Q100	Q200	Q300	2000
Domestic Revenues	15.4	14.8	14.9	15.6	16.6	17.8
<i>less</i> Domestic Non-Debt Expenditures	13.7	14.7	14.8	14.5	16.4	18.8
<b>DOMESTIC PRIMARY BALANCE (DBP)</b>	<b>1.7</b>	<b>0.2</b>	<b>0.1</b>	<b>1.1</b>	<b>0.2</b>	<b>-0.9</b>
<i>plus</i> Programme Grants	0.5	0.5	0.3	0.5	1.0	0.9
<i>less</i> Interest Payments	6.1	5.4	5.9	6.2	7.1	7.5
<b>OVERALL NARROW BALANCE (ONB)</b>	<b>-3.8</b>	<b>-4.7</b>	<b>-5.5</b>	<b>-4.6</b>	<b>-5.8</b>	<b>-7.6</b>
<i>plus</i> Project Grants	2.4	2.0	1.9	1.8	1.7	1.2
<i>less</i> Foreign-Financed Capital	6.8	5.4	5.7	5.4	5.9	5.1
<b>OVERALL BROAD BALANCE (OBB)</b>	<b>-8.2</b>	<b>-8.2</b>	<b>-9.3</b>	<b>-8.2</b>	<b>-10.1</b>	<b>-11.5</b>
<b>TOTAL FINANCING of which:</b>	<b>8.2</b>	<b>8.2</b>	<b>9.3</b>	<b>8.2</b>	<b>10.1</b>	<b>11.5</b>
<b>1. Divestiture Receipts</b>	<b>0.6</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>1.3</b>	<b>1.2</b>
<b>2. Borrowings</b>	<b>7.6</b>	<b>7.9</b>	<b>9.0</b>	<b>7.9</b>	<b>8.8</b>	<b>10.3</b>
<b>(a) Foreign (net)</b>	<b>2.6</b>	<b>0.9</b>	<b>1.4</b>	<b>1.1</b>	<b>0.5</b>	<b>0.0</b>
Programme Loans	1.2	1.1	1.6	1.5	1.9	3.0
Project Loans	4.4	3.4	3.8	3.6	4.3	3.9
Amortization	-3.0	-3.6	-4.0	-4.0	-5.6	-6.9
<b>(b) Domestic (net)</b>	<b>5.0</b>	<b>7.0</b>	<b>7.6</b>	<b>6.8</b>	<b>8.3</b>	<b>10.3</b>
<b>Official</b>	<b>3.7</b>	<b>5.2</b>	<b>5.4</b>	<b>5.7</b>	<b>6.4</b>	<b>8.8</b>
Banking	1.7	4.6	4.8	4.5	5.0	8.7
BoG	-2.0	0.9	1.0	1.7	3.9	6.6
DMBs	3.7	3.8	3.7	2.9	1.1	2.2
Non-Bank	2.0	0.6	0.7	1.2	1.4	0.1
<b>Unofficial (Arrears)</b>	<b>1.3</b>	<b>1.8</b>	<b>2.2</b>	<b>1.0</b>	<b>1.9</b>	<b>1.5</b>

Source: BOG, Ministry of Finance, and CEPA Staff Estimates

Trends in the various financing instruments are shown in Figure 3.2. Net foreign financing

declined from 2.6 percent of GDP in 1998 to 0.9 percent of GDP in 1999 and in year 2000 debt repayments exceeded new loan disbursements in spite of over \$20 million of external payment arrears. Correspondingly, net domestic financing, including CEPA's estimate of the domestic payment arrears, rose from 5 percent of GDP in 1998 to 7 percent of GDP in 1999 and sharply to 10.3 percent of GDP in 2000. Consequently, government domestic borrowing as a share of the total financing required rose from 61.5 percent in 1998 to 85.7 in 1999 and then to nearly 90 percent for the 2000 fiscal year.

**Figure 2.2: Sources of Financing Central Government Budget Deficit**



Official domestic financing of the fiscal operations of government —the PSBR— is a key performance criterion of the IMF's Poverty and Growth Facility (PRGF) Arrangement with Ghana. In an effort to meet the ceiling for the PSBR the government has often resorted to hidden liabilities by way of payment arrears accumulation. Net unofficial borrowing as a share of the domestic total increased from 26 percent in 1998 to 26.4 percent in 1999 before declining to 16.2 percent for 2000 fiscal year. The decline in the year 2000 is largely attributable to larger net official borrowing from the Bank of Ghana.

The issue of concern is the continued build-up of arrears and the absence of credible official estimates for both the annual flow and the stock. To address the problem, the IMF prescribed

within the context of an earlier PRGF Arrangement with Ghana as follows:

*To clarify the situation for domestic arrears, the government will undertake an audit that will be completed by December 2000.*

The said audit never materialised thus constituting yet another breach of the conditionalities under the Arrangement with the Fund. Not surprisingly this has become the subject of a structural performance criterion in the Letter of Intent of June 11, 2001.

In spite of the escalation in the build-up of payment arrears, the government has consistently exceeded the ESAF/PRGF ceilings on the PSBR. The out-turn exceeded the programme ceiling by 48 percent in 1998 and by 67 percent in 1999. For the 2000 fiscal year the overrun was an astronomical 939 percent. As a share of GDP government net official borrowing steadily increased from 3.7 percent in 1998 to 5.2 percent in 1999 and then rocketed to 8.8 percent in 2000.

The domestic banking system is the largest source of domestic borrowing by the government. This high dependence on the banking system for the government's fiscal operations has been a matter of considerable concern since it can potentially weaken monetary policy and increase the likelihood of rekindling inflation and inflationary expectations.

In 1998 nearly half of the ONB was financed by domestic bank credit. This rose to 96 percent in 1999. For the 2000 fiscal year, however, bank credit exceeded the amount needed to finance the ONB by nearly 12 percent on account of the use of domestic borrowing sources to meet external payments obligations.

An even more disturbing development in the year 2000 was the government's recourse to borrowing from the Bank of Ghana, which is tantamount to printing money. The government moved from being a net depositor with the Bank of Ghana in 1998 to a marginal net borrower in 1999. Net borrowing from the central bank in 2000 amounted to about ₵1790 billion, equivalent to 6.6 percent of GDP. Nearly ₵850 billion (about 50 percent) of this amount was borrowed in the last quarter of the year. Clearly borrowing from the central bank on this scale is imprudent. To rectify this the new government has constrained net domestic financing for the 2001 fiscal

year to be no more than ₵686 billion or about a third of what was borrowed from the central bank in the year 2000.

## 2.5 Domestic Revenues

After declining from 15.4 of GDP in 1998 to 14.8 percent of GDP in 1999, domestic revenue performance picked up in 2000 and improved to 17.6 percent of GDP. All the major categories of revenue, with the exception of cocoa export duties, contributed to the improved outcome. Nonetheless, collection arrears have been reported in respect of company taxes, import duties and cocoa taxes. There are two broad components to domestic revenues — taxes and non-tax receipts.

### 2.5.1 Domestic Non-Tax Receipts

Domestic non-tax receipts consist of income and fees and a miscellaneous category. The latter seems to have gained much significance in recent years. CEPA has, however, been drawing attention to the lack of transparency of the components of this revenue item. Official pronouncements about these change from one period to the next, thus adding to the confusion.

Inconsistencies of budgetary and balance of payments data together with the inadequacies of the expenditure monitoring system, have led CEPA to conclude that some project grants may, on occasion, have been misclassified as non-tax receipts. On other occasions capital gains in the balance sheet of the Bank of Ghana have also been credited to this revenue item.

Meanwhile, several fees, licenses and other charges have not kept pace with inflation in recent years. The need to correct this situation has been encouraged in the current PRGF Arrangement. The overall performance for the 2000 fiscal year in respect domestic non-tax revenue was the equivalent of 1.5 percent of GDP, a marked albeit unexplained improvement over the 1998 and 1999 outcomes of 0.4 percent of GDP.

	1998	1999	Q100	Q200	Q300	2000

CEPS Tax Collections	5.5	5.3	5.5	5.6	5.9	5.7
IRS Tax Collections	4.1	4.2	4.1	4.3	4.5	5.2
VAT/Sales/Service	3.2	3.7	3.8	3.9	4.4	4.7
Cocoa Exports Tax	2.2	1.2	1.0	0.8	0.9	0.7
<b>TAX REVENUE</b>	<b>15.0</b>	<b>14.4</b>	<b>14.3</b>	<b>14.6</b>	<b>15.7</b>	<b>16.3</b>
Income & Fees	0.4	0.1	0.0	0.0	0.0	0.4
Other	0.0	0.3	0.6	1.0	0.9	1.0
<b>DOMESTIC NON-TAX REVENUE</b>	<b>0.4</b>	<b>0.4</b>	<b>0.6</b>	<b>1.0</b>	<b>0.9</b>	<b>1.5</b>
<b>TOTAL DOMESTIC REVENUE</b>	<b>15.4</b>	<b>14.8</b>	<b>14.9</b>	<b>15.6</b>	<b>16.6</b>	<b>17.7</b>
<b><i>Memorandum Items</i></b>						
Divestiture & NPART	0.6	0.2	0.3	0.3	1.3	1.2
<b>Foreign Grants</b>	<b>3.0</b>	<b>2.4</b>	<b>2.2</b>	<b>2.3</b>	<b>2.7</b>	<b>2.1</b>
Program	0.5	0.5	0.3	0.5	1.0	0.9
Project	2.4	2.0	1.9	1.8	1.7	1.2
<i>Source: BOG, Ministry of Finance, and CEPA Staff Estimates</i>						

## 2.5.2 Tax Revenues

At 16.3 percent share of GDP, tax revenue performance for the year 2000 was better than that of the preceding two years. The performance of the three revenue-collecting agencies — CEPS, IRS and the VAT Service — broadly conformed to this general trend. However, in spite of the massive cedi depreciation, the continued slide in the price of cocoa in world markets impacted negatively on collections of cocoa export duties.

### 2.5.2.1 Collection by CEPS

The Customs, Excise and Preventive Service (CEPS) has responsibility for duties and taxes on

imports, taxes levied on petroleum products, and excise duties on domestic goods and services.<sup>5</sup> As indicated in CEPA's *Mid-Year Macroeconomic Review for 2000*, "a by-product of the over-valued cedi of the past several years has been the rather rapid build-up of the non-oil import bill. This has put the not too impressive performance of CEPS under the searchlight. The conclusion has been that large government revenues have been lost largely on account of lack of effective supervision and transparency of the bonded-warehousing facility operated by CEPS". The overall performance of 5.7 percent of GDP in 2000 is an improvement over the 5.3 percent of GDP for 1999 and the 1998 outcome of 5.5 percent of GDP. However, the GDP is not a good proxy for the base for the majority of tax components under CEPS, especially where large devaluations occur.

	<b>1998</b>	<b>1999</b>	<b>Q100</b>	<b>Q200</b>	<b>Q300</b>	<b>2000</b>
<b>Total Collections</b>	<b>5.5</b>	<b>5.3</b>	<b>5.5</b>	<b>5.6</b>	<b>5.9</b>	<b>5.7</b>
Import Duties & Taxes	2.5	2.6	2.8	2.8	2.9	3.0
Domestic Goods & Services	3.0	2.7	2.7	2.7	2.9	2.7
<i>Excise Duties</i>	0.9	0.9	0.9	0.8	0.9	0.8
<i>Petroleum Taxes</i>	2.1	1.8	1.8	1.9	2.0	2.0

*Source: BOG, Ministry of Finance, and CEPA Staff Estimates*

### Excise Duties

Collection of excise duties which are levied on the narrow set of goods consisting of tobacco products and beverages and, more generally, the excisable goods considered "luxuries" declined marginally from 0.9 percent of GDP for 1998 and 1999 to 0.8 percent of GDP in year 2000.

### Petroleum Taxes

The regime of taxes on petroleum products is mixed and is made up of two parts: an *ad valorem*

<sup>5</sup> Administratively CEPS collects the import VAT on behalf of the VAT Service while the VAT Service collects excise duties on domestic goods and services on behalf of CEPS.

component, which is based on the cedi-value of the ex-refinery price; and a *specific* component, which is assessed on per unit basis. A special report on petroleum pricing policy is presented in Section 2.8.

Amidst fears of cost-push inflation from oil price hikes in world markets and the fast depreciating cedi, the increase approved by Parliament in the specific fuel levy for the Road Fund from ¢150/litre to ¢230/litre was never implemented. Yet, the Budget estimate for this item was based on a January 1, 2000 effective implementation date. Not surprisingly, the Budget projection of ¢300 billion for the Road Fund fell short by ¢45 billion. The adverse consequence of this shortfall for the maintenance of the nation's road network is yet to be fully assessed. Moreover, government's decision to freeze the ex-pump price of petroleum products in spite of the tripling of the price of crude oil in world markets and the steep depreciation of the cedi resulted in some revenue loss and, even more disconcertingly, brought the financial viability of the Tema Oil Refinery (TOR) into serious question. The TOR is reportedly indebted to the banking system to tune of ¢2.5 trillion as at end-December 2000.

### Import Duties and Taxes

Trade data from CEPS indicate that the dollar value of non-oil imports for the year 2000 was some 23 percent below the value reported for 1999.<sup>6</sup> Consequently, the performance in import duty collections of 3 percent of GDP for the 2000 fiscal year — the highest since 1998 — is largely the result of the sharp depreciation of the cedi, which averaged over 100 percent for the year. A better way to judge this performance is to look at the effective duty rates since they give an indication of the efficiency of the CEPS collection machinery. Given the import duty rate and exemption structure, the average duty rate for the year 2000 was projected at 7.02 percent. The realized effective duty rate, however, was lower at 6.43 percent. Moreover, it was below the 1998

and 1999 outcomes of 8.59 percent and 6.69 percent, respectively. While this development is

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*6 The import data from CEPS used here differs from that used in the Balance of Payments section of this Report. The latter, obtained from the Ministry of Trade and Industry includes, among other things, re-exports and imports into the Export Free Zones. The data also suggests that a substantial part of the sharp rise in non-oil imports of 1999 was on account of "election imports" for 2000 which, moreover, would be tax-exempt. Relatedly, to the extent that these imports were passed through private agents, collection arrears could arise.*

consistent with reports of collection arrears in respect of import duties it also, in part, reflects the impact of increased exemptions in an election year.

The data also suggest that sharp increases in the tax base on account of the exchange rate correspond with increased evasion that consequently weakened tax collection effort or equivalently reduced efficiency of the collection machinery.

#### 2.5.2.2 Collection by the IRS

The Internal Revenue Service (IRS) collects personal income taxes (PAYE), taxes on the self-employed, and corporate income taxes. It is also responsible for a miscellaneous tax group that includes taxes on rent income. The overall performance of 5.2 percent of GDP for the year 2000 was a marked improvement over the 4.1 percent of GDP recorded in the two previous years.

	<b>1998</b>	<b>1999</b>	<b>Q100</b>	<b>Q200</b>	<b>Q300</b>	<b>2000</b>
<b>Total Collections</b>	<b>4.1</b>	<b>4.2</b>	<b>4.1</b>	<b>4.3</b>	<b>4.5</b>	<b>5.2</b>
Personal Income (PAYE)	1.2	1.5	1.5	1.7	1.8	1.8
Self-Employed	0.2	0.3	0.2	0.3	0.3	0.3
Companies	2.1	2.1	1.9	1.7	1.8	2.6
Other (incl. rent)	0.6	0.4	0.5	0.6	0.6	0.6

*Source: BOG, Ministry of Finance, and CEPA Staff Estimates*

#### Company Taxes

After dropping to 1.7 percent of GDP at the end of June, company taxes picked in the second half and improved to 2.6 percent of GDP for the fiscal year. This surge in performance may be attributable to renewed vigilance on the part of the IRS in the fourth quarter in respect of collection of arrears. The expectation is that this latter effort would be sustained in the year 2001.

#### Other Direct Taxes

Collection performance in respect of the self-employed was maintained at the 1999 level of 0.3

percent of GDP while that of miscellaneous taxes, measured as ratio to GDP, improved from 0.4 percent 1999 to the 1998 level of 0.6 percent. It would appear that the administrative arrangements with the various organisations including the Ghana Private Road Transport Union (GPRTU), the Tailors and Dressmakers Association, the Beauticians and Hairdressers Association, and the Ghana United Traders Association (GUTA) have been effective in improving collections. The tax/GDP ratio of 1.8 percent in the case of PAYE taxes was also the highest since 1998.

### 2.5.2.3 Collections by the VAT Service

The VAT rate was increased by 25 percent from 10 percent to 12.5 percent for the 2000 fiscal year. However, because of implementation delays, the rate increase did not become effective until June 1, 2000. Consequently the rate increase accounted for only 12 percent of the domestic VAT collections and 14 percent of the import VAT. The domestic VAT improved marginally from 1.3 percent of GDP in 1999 to 1.4 percent of GDP in 2000 while, as would be expected from the increase in the base of about 50 percent, the import VAT improved from 2.4 percent of GDP in 1999 to 3.3 percent of GDP — an increase in the ratio by 35 percent.

The efficiency of the VAT as a tax handle was evident in year 2000. Unlike import duties the realised effective average import VAT rate of 7.06 percent fell only marginally short of the projected average rate of 7.10 percent. This is a clear indication that the VAT paper trail makes it relatively difficult to avoid compliance. Since the CEPS administration collects the import VAT, the relative drop in import duty collections mentioned earlier is a pointer to how much more difficult it is to avoid or evade the VAT, i.e. to the efficiency of the VAT as a tax handle.

<b>Table 2.6: VAT Service Tax Collections (%of GDP)</b>						
	<b>1998**</b>	<b>1999</b>	<i>Q100</i>	<i>Q200</i>	<i>Q300</i>	<b>2000</b>

<b>Total Collections</b>	<b>3.2</b>	<b>3.7</b>	<b>3.8</b>	<b>3.9</b>	<b>4.4</b>	<b>4.7</b>
Domestic	1.6	1.3	1.3	1.2	1.3	1.4
Import	1.6	2.4	2.5	2.7	3.1	3.3
<i>Source: BOG, Ministry of Finance, and CEPA Staff Estimates</i>						
<i>** Sales taxes for 1998; VAT became operational from 1999.</i>						

Finally, as shown in Box 2.4, due to the one-month lag in the submission of returns in respect of the domestic VAT, the effective increase in the VAT rate of the domestic VAT was 11.4 percent, somewhat lower than 12.4 percent increase for the import VAT.

#### 2.5.2.4 Cocoa Export Duties

In spite of a 9.4 percent increase in sales volume over the 1999 outcome, the 30.3 percent fall in average export prices from \$1450 in 1999 to \$1010 in 2000 resulted in a 23.8 percent decline in total dollar export earnings. Nonetheless, the 48.9 percent depreciation of the cedi<sup>7</sup> resulted in a 13.5 percent increase in cedi export receipts.

The projection for cocoa export duties was revised from ₵160 billion to ₵205 billion during the course of the year, purportedly to reflect the higher than programmed depreciation. The provisional outcome shows that the cedi depreciated by much more than implied even in the revised projected cocoa export duty. Minor revisions also occurred in respect of the average producer price and volume sales during the course of the year. After accounting for the revision in producer prices, marketing and other operational costs, the cocoa export duty — calculated as a residual would have amounted to ₵237.8 billion. The ₵179.8 billion reported as cocoa export duties therefore raises legitimate questions about tax arrears by Cocobod. However, unbudgeted amounts of ₵38.9 billion and ₵17.4 billion in respect of retrenchment expenses and local finance costs, respectively, could well be the explanation for the shortfall in cocoa export duties.

#### **Box 2.4: Determining the Effective Value-Added Tax Rate**

*Let  $v$  = the %-age effective change in the VAT rate;  
 $b$  = the %-age change in the tax base of the VAT;  
 $C_0$  = collection in the base period 1999; and*

<sup>7</sup> The cedi depreciation reported here is based on the exchange rate in effect at the time of converting cocoa finance loans into cedis and, therefore, differs from the average depreciation of over 100 percent for the fiscal year reported by the Bank of Ghana. This could raise technical problems of tax arrears in respect of cocoa.

$C_1$  = collection in year 2000

We can then define:

$$C_1 = (1+v)(1+b)C_0; \text{ and}$$

$$GDP_1 = (1+g)(1+\pi)GDP_0$$

Where  $GDP_1$  = the nominal GDP in year 2000;  $GDP_0$  = nominal GDP in the base year – 1999 in our case;  $g$  = the growth in real GDP; and  $\pi$  is the rate of inflation.

$$C_1/GDP_1 = \{(1+v)(1+b)C_0\}/\{(1+g)(1+\pi)GDP_0\}$$

### **Domestic VAT**

For the domestic VAT, GDP is assumed to be a good proxy for the base so that:

$$(1+b) = (1+g)(1+\pi)$$

Thus,  $C_1/GDP_1 = \{(1+v)(C_0/GDP_0)\}$

Using historical data, this translates (in percentage terms) into:

$$0.01432 = (1+v) 0.01285$$

$$\Rightarrow 1+v = 1.1137$$

$$\Rightarrow v = 0.1137$$

Thus, in year 2000, the effective change in the domestic VAT rate was 11.37 percent compared to the statutory increase of 25 percent.

### **Import VAT**

For the import VAT, non-oil imports are assumed to be a good proxy for the base. However, because the VAT is levied on the import duty inclusive of the value of imports, it follows that:

$$(1+b) = (1+e)(1+m)\{(1+T_1)/(1+T_0)\}$$

where  $T_0$  and  $T_1$  are the average import duty rates in the base and current periods respectively;  $e$  is the rate of nominal depreciation of the cedi relative to the US dollar; while  $m$  is the percentage in the dollar value of non-oil imports.

Thus,  $C_1/GDP_1 = \{(1+v)(1+e)(1+m)(1+T_1)\}/\{(1+g)(1+\pi)(1+T_0)\}(C_0/GDP_0)$

Manipulating this algebraically yields the following expression:

$$C_1/GDP_1 = \{(C_0/GDP_0)[(1+T_1)/(1+T_0)]\}\{(1+e)(1+m)\}/\{(1+g)(1+\pi)\}(1+v)$$

Again, using historical data for 1999 and year 2000, this translates into:

$$0.03265 = 0.02420\{(1.07015)/(1.06738)\}\{(1.5172/1.2622)\}(1+v)$$

$$\Rightarrow 0.03265 = (1+v) 0.02906$$

$$\Rightarrow 1+v = 1.1244$$

$$\Rightarrow v = 0.1244$$

Thus, in year 2000, the effective change in the import VAT rate was 12.44 percent.

## **2.6 Government Expenditures**

Shortly after Parliament had approved the Budget for the 2000 fiscal year, the government gave an undertaking in March 2000 to the IMF to identify and seek cabinet approval to postpone, until

the second half of the year, a package of contingent non-debt domestic expenditures equivalent to at least 1 percent of GDP. The fate of these expenditures was to be determined by the budgetary outcome at the end of June. In particular, they would be entirely eliminated if the fiscal stance did not show much improvement. Events that unfolded during the course of the year indicate that the postponement of these expenditures was, at best, illusory as commitments were on going and could not be contained. The situation culminated in the build-up of payments arrears and when this proved unsustainable it led to a surge in domestic bank borrowing, especially from the Bank of Ghana, in the latter part of year.

These developments highlighted CEPA concerns in earlier reports about the expenditure estimates in the budget and the role of Parliament itself in the budgetary process. In particular, drawing on data from the Controller and Accountant General's Department (CAGD), CEPA drew attention to the increasing irrelevance of the budgetary hearings and the parliamentary for 1999. In several instances the data revealed a high incidence of expenditures incurred without prior approval by Parliament while, in other cases, there were reported expenditures that fell far short of the approved estimates — savings that on closer examination turned out invariably to be payments arrears.

The payments arrears problem, which became an on-going process, continues to blur any objective assessment of the budgetary stance. In spite of a declared clearance of ₵484.4 billion of existing stock, new arrears of a non-statutory nature were accumulated in year 2000 of which those in respect of the road sector amounted to ₵196 billion. Besides, various press reports affirmed CEPA's position about the existence of substantial non-road related arrears that are yet to be settled. Government reportedly released an additional ₵2 billion in September for payments in respect of service conditions of teachers for 1997 and 1998. Also, there were reports that subventions to the National Commission for Civic Education (NCCE) had been delayed, an unacceptable situation bound to undermine the operations of the Commission in an election year.

	<b>1998</b>	<b>1999</b>	<i>Q100</i>	<i>Q200</i>	<i>Q300</i>	<b>2000</b>
<b>RECURRENT EXPENDITURE</b>	<b>16.2</b>	<b>15.4</b>	<i>15.6</i>	<i>15.9</i>	<i>17.5</i>	<b>18.6</b>

<b>Non-Debt</b>	<b>10.1</b>	<b>10.0</b>	<b>9.7</b>	<b>9.7</b>	<b>10.5</b>	<b>11.0</b>
Personnel Related	6.7	6.8	6.8	6.7	6.9	6.8
<i>Personnel Emolument Group</i>	5.9	6.0	6.0	5.9	6.1	5.8
Wages and Salaries	5.3	5.4	5.4	5.3	5.5	5.2
Social Security	0.6	0.6	0.6	0.6	0.6	0.6
<i>Pensions &amp; Gratuities</i>	0.8	0.8	0.8	0.8	0.9	1.0
Items 2-5	2.0	1.8	1.7	1.8	2.0	2.6
Subventions	1.5	1.3	1.3	1.3	1.5	1.6
<b>Interest Payments</b>	<b>6.1</b>	<b>5.4</b>	<b>5.9</b>	<b>6.2</b>	<b>7.1</b>	<b>7.5</b>
Domestic	4.9	4.1	4.4	4.8	5.1	5.3
External	1.2	1.3	1.5	1.4	2.0	2.2
<b>CAPITAL EXPENDITURE</b>	<b>9.1</b>	<b>8.1</b>	<b>8.7</b>	<b>8.3</b>	<b>9.8</b>	<b>10.6</b>
<b>Domestic Financed</b>	<b>2.3</b>	<b>2.7</b>	<b>3.0</b>	<b>2.9</b>	<b>3.8</b>	<b>5.4</b>
Development	1.3	1.9	2.3	2.1	3.0	4.4
Net Lending & Equity	0.3	0.0	0.0	0.0	0.0	0.2
<i>New Loans</i>	0.5	0.0	0.0	0.0	0.0	0.2
<i>Recoveries</i>	-0.2	0.0	0.0	0.0	0.0	0.0
D. A. Common Fund ( <i>DACF</i> )	0.8	0.7	0.7	0.7	0.8	0.8
<b>Foreign Financed</b>	<b>6.8</b>	<b>5.4</b>	<b>5.7</b>	<b>5.4</b>	<b>5.9</b>	<b>5.1</b>
<b>ESTIMATED ARREARS (non statutory)</b>	<b>1.3</b>	<b>2.0</b>	<b>2.1</b>	<b>1.9</b>	<b>2.1</b>	<b>2.3</b>
<b>TOTAL EXPENDITURE</b> (commitments)						
<b>Domestic Non-Debt</b>	<b>13.7</b>	<b>14.7</b>	<b>14.8</b>	<b>14.5</b>	<b>16.4</b>	<b>18.8</b>
<b>Narrow</b>	<b>19.8</b>	<b>20.0</b>	<b>20.7</b>	<b>20.7</b>	<b>23.4</b>	<b>26.3</b>
<b>Broad</b>	<b>26.6</b>	<b>25.4</b>	<b>26.4</b>	<b>26.1</b>	<b>29.4</b>	<b>31.5</b>

Source: BOG, Ministry of Finance, and CEPA Staff Estimates

Moreover, contrary to the statutory provisions, there were no transfers into the District Assemblies Common Fund (DACF) in the first half of the year. Thus, for the year as a whole, the pipeline of these transfer arrears lengthened to two and half quarters approval process in its

*Mid-Year 2000 Macroeconomic Review and Programme.*

The IMF, in the context of the PRGF Arrangement, prescribed that the government undertake an audit of arrears by end-December 2000. This conforms to a previous CEPA suggestion “to transparently declare the size of the outstanding stock through a proper audit and then formalise it so that it becomes part of the official debt stock”.<sup>8</sup> The recommendation at the 1999 Consultative Group Meeting to set up an Internal Debt Relief Fund to deal decisively with the mounting domestic debt problem will not achieve the desired outcome without this all important intermediate step, and may indeed have contributed to the Fund not being established.

The above underscores the need to treat official data with some circumspection. The Government resolutely refused to recognise the arrears situation as an ongoing process, and provisional actuals have continued to be on payments rather than on commitments basis. As in the past, CEPA has had to make adjustments in order to bring overall expenditures to commitments basis. It is the only way to ensure a proper assessment of fiscal performance. To the extent possible the expenditure stance presented in this report will reflect such adjustments, albeit, as has been the practice, not by line item.

### ***2.6.1 Non-Debt Domestic Expenditures***

Government finance information under the Medium-Term Expenditure Framework (MTEF) classification has proven inadequate, as many ministries, departments and agencies (MDAs) of government have still not implemented the concept fully. The fact is that the MTEF is yet to become fully operational. Assessment of the expenditure stance in this report is, therefore, carried out under the old system of classification.

There are two broad components to domestic non-debt expenditures — domestic non-debt recurrent expenditures and domestically financed capital expenditures. The recurrent component consists of: personnel-related expenses (**Item 1**) — personal emoluments, social security contributions of government as employer (transfers to SSNIT), and transfers of pensions and

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<sup>8</sup> CEPA: *Macroeconomic Review and Outlook, January to June 2000*, pg. 12

gratuities to households; purchases of goods and services (**Items 2-5**); and subventions to public and private non-profit institutions and organisations (**Item 6**). The capital component comprises domestically funded development expenditures by the central government, transfers into the Road Fund, the Educational Trust Fund, and the District Assemblies Common Fund (DACF), and net lending to enterprises both public and private.

With the exception of a few items, notably the statutory payments — personal emoluments, social security contributions of government as employer, and transfers to the District Assemblies and the Education Trust Fund — it has not been possible for estimates of payments arrears to be made for individual expenditure items. Nonetheless, based on supplementary data including from the banking system, CEPA has been able to make reasonable estimates of the build-up of the stock of arrears over time. Thus, while some of the individual expenditure items are presented on a payments basis from the official statistics, a correction is made for the total expenditure to bring it to commitments basis.

Domestic non-debt expenditures excluding non-statutory arrears for the fiscal year amounted to 16.5 percent of GDP, a sharp increase from the 1999 as well as the annualized mid-year 2000 outcome of 12.6 percent of GDP. It is thus clear that the deferral of expenditures equivalent to at least 1.0 percent of GDP to the second half of the year could not be sustained. On a net basis CEPA estimates show that incremental non-statutory arrears have steadily risen from 1.3 percent of GDP for fiscal 1998 to 2.3 percent of GDP for the 2000 fiscal year. As a result, total domestic non-debt expenditures including arrears — commitments basis — was equivalent to 18.8 percent of GDP in year 2000, the highest in recent times. This latter clearly underlines CEPA's concern about the distorted nature of performance assessments based on payments data — especially in respect of the borrowing pressure exerted by the government on the domestic economy.

#### *2.6.1.1 Recurrent Expenditures*

##### *Personnel-Related Expenditures*

On a commitments basis personal emoluments, including the SSNIT contribution, amounted to 5.8 percent of GDP for the 2000 fiscal year. For the 1998 and 1999 fiscal years the personal emoluments group averaged about 6.0 percent of GDP, an indication that wages and salaries in

the public sector did not keep pace with nominal national income growth in year 2000.

In the case of pensions and gratuities the year 2000 out-turn of 1.0 percent of GDP was a slight increase over the 0.8 percent of GDP outcome for both 1998 and 1999. Some “heavy” end-of-service benefits (ESBs) must have been paid in the earlier years and debited to year 2000.

However, on commitments basis, total personnel-related expenses — wages and salaries of workers in the public sector including government’s contribution to SSNIT as an employer, transfers to pensioners, and gratuities to households — kept pace with nominal income growth.

#### Subventions and Items 2-5

Transfers to subvented organisations and the expenditures on goods and services labelled Items 2-5 increased substantially in the second half of the year after being held in check at the 1999 levels for the first half-year. In the case of subventions the 2000 outcome of 1.6 percent of GDP included increased transfers to subvented organisations outside the state sector. The outcome in respect of Items 2-5 expenditures was substantially above the provisional actuals for both 1998 and 1999. All these increased tempo of spending and payments were presumably on account of increased spending on travel and transport and other related expenses in an election year.

#### 2.6.1.2 *Capital Expenditures*

##### Transfers into the DACF

Indications are that transfers into the DACF were in arrears of two and half quarters thus violating the statutory requirements for the 2000 fiscal year. On commitments basis transfers into the DACF should have amounted to 0.8 percent of GDP matching the commitments for 1998 and slightly above the 1999 commitments of 0.7 percent of GDP. Mounting payments arrears from the operations of the District Assemblies have been included in the estimated stock of informal or unofficial debt.

##### Transfers into the Education Trust Fund

Transfers into the Education Trust Fund were also technically in arrears to the tune of ₵134.8

billion. The commitments should have been ₵166.8 billion, equivalent to 0.6 percent of GDP. Since the Fund is expected to finance capital expenditures this would also contribute to payments arrears to contractors — building and road.

### Transfers into the Road Fund

Transfers into Road Fund as share of GDP declined two years in a row from 1.1 percent in 1998 to 1.0 percent in 1999 and to 0.9 percent in year 2000. The decline in 2000 is, in part, attributable to government's failure to implement the 53.3 percent increase in the Road Fuel levy approved by Parliament because of the implications for fuel and transport costs in an election year. The Road Fund is earmarked for routine and periodic maintenance of the nation's roads and highways. As pointed out in Section 3.7.3 the postponement of maintenance expenditure as a means of moderating the deficit is an illusion since it ultimately results in higher costs of reconstruction in the future. Payments arrears cannot be ruled out in this sector as well.

### Other Domestically Financed Development Expenditures

Other domestically-funded development expenditures rose from 0.2 percent of GDP in 1998 to 0.9 percent of GDP in 1999 and then sharply to 2.9 percent of GDP in 2000. The 2000 outcome may be reflection of election year spending to bring on-going development projects to completion and possibly to start new projects for partisan advantage in an election year.

## **2.6.2 Interest Payments on the National Debt**

Interest on the national debt (domestic and foreign) regained its importance as the largest single item of government expenditure in fiscal year 2000 — constituting over 40 percent of total recurrent expenditures. The payments of 7.5 percent of GDP exceeded the previous record high of 6.1 percent of GDP for the 1998 fiscal year. The relative moderation in interest payments in 1999 of 5.4 percent of GDP was achieved not only as a result of the decline in the interest rates on Treasury bills but also due to postponed external debt service payments.

After declining from 4.9 percent of GDP in 1998 to 4.1 percent of GDP in 1999, interest expenditure on the domestic debt rose sharply to 5.3 percent of GDP in year 2000. This rapid

build-up in payments was pioneered by the increase in the Treasury bill rate from 31.5 percent end-December 1999 to 38.0 percent end-December 2000 and a 31.8 increase in the stock of Treasury bills from ₵3790 billion at the end of 1999 to ₵4997 billion at the close of year 2000.

Contrary to the popular misconception that domestic borrowing by government was essentially in respect of domestic interest payments, the available data indicates that domestic interest payments were equivalent to 78 percent of domestic borrowing in 1999 and an even lower 60.3 percent in year 2000. In general the amount of domestic borrowing is determined by a combination of factors: the size of the budget deficit, net foreign financing, the treatment of divestiture and other capital receipts, and the extent of hidden liabilities incurred by government.

The empirical evidence tends to support the view that, in Ghana's case, barring arrears, foreign borrowing and domestic borrowing are substitutes. Thus in 1998 when foreign borrowing was 2.6 percent of GDP the official domestic amounted to 3.7 of GDP. Foreign borrowing dwindled to 0.9 percent of GDP in 1999 and in the year 2000 repayments of foreign loans exceeded new inflows. Correspondingly, official domestic borrowing increased to 5.2 percent in 1999 and to 8.8 percent of GDP in year 2000.

## **2.7 The Domestic Debt Overhang**

Ghana faces an unsustainable domestic debt overhang. Past expansionary fiscal policies and continued high interest rates have led to a high burden of domestic debt that remains a major obstacle to private sector-led growth — indeed to the development of a strong and productive private sector. The stock of official domestic debt at the end 2000 was ₵7842.3 billion, equivalent to 28.9 percent of GDP.

Interest payments on the domestic debt was the single largest item of government expenditure in the year 2000 accounting for nearly a 30 percent of total recurrent expenditures, and equivalent to 5.3 percent of GDP. The high domestic interest payments reflect the impact of the heavy burden of the domestic debt, the unusually large proportion of short-term debt instruments, — about 64 percent of the total — and the rising trend of interest rates. They also reflect the

influence of continued expansionary fiscal policies in the context of a policy of monetary restraint.

In addition to the large outstanding stock of the official domestic debt, there are also payment arrears owed to suppliers of goods and services to government, including road contractors. The size of this unofficial debt has been growing rapidly in recent years. And yet no serious attempts have been made to get some accurate measure of the stock of these arrears. The stock needs to be properly audited, clarified and included in the official stock for a more rationalized policy on the domestic debt issue. CEPA has estimated that the payments arrears stock at the end of 2000 was equivalent to 4.1 percent of GDP. Rather distressingly, the interest burden on the Budget does not show any signs of abating. These developments call for a proper and coherent policy on debt management.

To this end we re-emphasise our position in previous CEPA publications that, among other things, proceeds from divestiture sales and other capital receipts be dedicated to the retirement of the domestic debt, particularly those of short-term maturity. Furthermore, advantage should be taken of the respite from external debt relief to pare back the domestic debt as well. This will have the effect of reducing the interest burden on the Budget in future years. The contrary is unacceptable and counterproductive.

## **2.8 Fiscal Irresponsibility and Fiscal Illusion**

This section draws extensively from the work of William Easterly (1998)<sup>9</sup>. Fiscal adjustment is an illusion when it lowers the budget deficit or public debt but leaves government net worth unchanged. Conventional measures of the deficit mostly capture the change in explicit or officially acknowledged government liabilities (debt), and often fail to capture the change in government assets or the change in implicit or unofficial liabilities. Economists have widely accepted the change in net worth definition of the deficit as the right conceptual measure.

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<sup>9</sup> William Easterly, "When is Fiscal Adjustment an Illusion?", paper presented at the 27<sup>th</sup> Panel Meeting of *Economic Policy* in Vienna, October 16-17, 1998.

Adjustment programmes supported by the IMF and the World Bank typically use a conventional deficit such as the public sector borrowing requirement (PSBR). Under plausible conditions, however, a government will lower the conventional deficit while leaving the path of net worth unchanged. The government would then follow its optimal path of net worth and would be indifferent about its composition. When required by an outside agent or Parliament to lower its debt accumulation, the government will lower its asset accumulation or increase its hidden liability accumulation by an equal amount. In such a case, fiscal adjustment is an illusion. The net worth definition of the deficit will only improve if the government has a change of heart and places higher value on future relative to current consumption. Alesina and Perotti (1995) found that deficit adjustments made by cutting government consumption were more lasting than those reduced in other ways<sup>10</sup>.

The government's intertemporal budget constraint states that net worth must be greater than or equal to the present value of all future consumption. Since this latter is certainly positive, net worth must always be positive. If net worth threatens to be negative, then an insolvent government would default on its liabilities.

The government's discount rate (for the computation of the present value of all future consumption) is a useful indicator of "fiscal irresponsibility". A fiscally irresponsible government — one with a high discount rate — will value consumption today at the expense of future consumption. One reason for a high discount rate is where the government does not expect to stay in power for long, for example on account of a short electoral cycle. It can be demonstrated as a general proposition of rational behaviour that the higher the probability of "death", the lower the savings rate (and hence average individual wealth). Here "death" is used in reference to the duration in power. A sufficiently high discount rate could result in a low or possibly even negative change in worth — reduction in net worth. A fiscally irresponsible government is one that in the long-run (steady state) would bequeath an under-provision of profitable capital services, an excessive debt ratio, and excessive implicit or unofficial liabilities.

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<sup>10</sup> Alesina and Perotti (1995), "Fiscal Expansions and Adjustments in OECD Countries" in *Economic Policy*, vol. 20, pages 205-208.

Zaire under Mobutu has been cited as an example of the pathological case of fiscal irresponsibility where the government's discount rate was so high that the change in net worth was negative. The government, for a considerable length of time, disinvested in its revenue generation capacity and infrastructure to the extent that the state started slowly withering away. The official sector disintegrated due to the failure to provide elementary infrastructure. Tax revenue/GDP ratio collapsed from 30 percent in 1973 to less than 5 percent by the 1990s.

*By 1994, the state had shrivelled to little more than the presidential yacht, a presidential guard unit, Mobutus's palace in his birthplace Gbadolite, and a skeleton state superstructure funded by diamond smuggling.*

The lesson is clear! Fiscal adjustment that exogenously shifts down the provision of public goods could set off a vicious circle with calamitous effects on revenues.

The Interim Committee of the IMF and the Bank in 1996 showed its awareness of these issues of fiscal illusion and fiscal irresponsibility and their consequences by calling for actions "to enhance the transparency of fiscal policy by persevering with efforts to reduce off-budget transactions and quasi-fiscal deficits". Ownership of policy reform processes — so crucial for effective implementation — could be based on indicators that reveal whether the government concerned has an appropriately low discount rate.

Monitoring progress of the reform process should include constant lookout for signs of asset de-accumulation or hidden liability accumulation. The example of New Zealand shows that a low discount rate government can try to bind its own hands with accrual and balance sheet accounting: the balance sheet can provide an indication of whether the government is running down its estate in order to maintain current consumption.

There is a hierarchy of possible public sector balance sheets that can be constructed. However, it is difficult to carry out such computations in very many countries, especially poor countries where the paucity of relevant data is widespread. Indeed, "defining government net worth is far from operational". In practice, the minimum would be to estimate the change in whatever can be measured in the comprehensive balance sheet by monitoring all asset sales and changes in asset accumulation and all new liability accumulation. Such an approach would focus, among others,

on the following:

- Fiscally-motivated privatisation and divestiture;
- Cuts in public investment;
- Cuts in operations and maintenance;
- Expenditure and/or revenue shifting over time;
- High pension liabilities despite current pension surpluses; and
- Shifting expenditure and debt off budget.

### **2.8.1 Privatisation**

The most transparent means of reducing government assets is privatisation. The economics profession has, however, not been consistent on how to treat privatisation proceeds:

- as revenue in which case they directly reduce the deficit; or
- as (negative) financing, in which case they could be applied to reduce the debt but not the deficit.

The Government Finance Statistics (GFS) Manual of the IMF (1986) treated privatisation proceeds as revenue — the first option. Over time, however, Fund practice has shifted to the second. The deficit definition for the Maastricht convergence criteria is based on the second option, which allows the proceeds from privatisation to be applied towards a reduction of the official or gross public debt to reach the debt/GDP target. Due to data limitations the CEPA treatment ends up the same way although a strict application of the net worth principle would use net rather than gross debt as the policy target.

Privatisation often makes possible significant efficiency gains. However, something is amiss when governments develop an interest in privatisation during fiscal austerity. Privatisation by a corrupt government is likely to end up in consumption by the ruling class and a consequential lowering of the public sector net worth.

Developing countries are not the only ones to privatise during periods of austerity. Indeed, as the director of the US Congressional Office reportedly observed, the Gramm-Rudman-Hollings Law

of 1985 encouraged “transparent budget gimmickry” such as “sale of assets”. The Congressional Budget Plan was also said to have induced prepayment of rural electrification loans (counted as revenue) by eliminating prepayment penalties even though that worsened government net worth by losing assets that paid interest rates above current market rates.

### **2.8.2 Public Investment**

Another well-known means of reducing asset accumulation when forced to reduce debt accumulation is to reduce public investment. A stylised empirical finding is that in periods of restrictive fiscal policies capital expenditures are the first to be reduced and often drastically too. The World Development Report (1988) of the World Bank found that governments cut capital spending by about 35 percent — far more than in respect of other public sector categories. And the World Bank reported in 1994 that when African countries lowered their budget deficits from 1981-86 to 1990-91, “most of the cuts were in capital spending”.

Admittedly, public investments do contain “white elephants” but they also contain investment that will pay government’s future returns. The World Bank has estimated rates of return to infrastructure during 1983-92 ranging from 19 percent (for telecommunications) to 29 percent (for highways). There are also profitable SOEs. The Zambian government disinvestments in the state copper company ZCCM to meet deficit targets has been cited as a contributory factor to the production decline from 700,000 tonnes a year in 1972 to 300,000 tonnes in the 1990s — a fall of 57 percent. Similarly, mineral production in the Zairian state company GECAMINES collapsed from 500,000 tonnes in 1988/89 to just over 40,000 tonnes in 1994/95. Among the factors leading to this collapse was “insufficient investment, which led to the obsolescence and decay of equipment and the cave-in of a major mining site (Kamoto mine) in 1990”, according to an IMF report issued in 1996.

Virtually all commonly used deficit definitions treat public investment as expenditure rather than below the line asset accumulation. Governments can therefore improve the apparent fiscal position by substituting private for public investment in infrastructure — for example toll roads — thereby reducing overall government spending. And yet to attract the private investment,

governments often have to offer implicit or explicit guarantees that may create future fiscal burdens greater than the initial reduction in public spending.

In the late 1980s and early 1990s, Mexico franchised out private construction and operation of about 5,000 kilometres of highways. When anticipated demand failed to materialise, many franchise operations faced financial ruin. The government reportedly gave more than \$6 billion in subsidies to save the operations from bankruptcy.

### **2.8.3 Operations and Maintenance (O & M)**

A third means of reducing asset accumulation is to reduce O&M spending. The World Bank has noted that inadequate spending on O&M during fiscal adjustment reduces current asset values and/or requires future spending to restore those assets. According to the World Bank's Adjustment in Africa Research Report (1994):

*Timely maintenance of \$12 billion would have saved road re-construction costs of \$45 billion in Africa in the past decade. On average, inadequate maintenance means that power systems in developing countries have only 60 per cent of the generating capacity available at a given time, whereas best practice would achieve levels of over 80 percent. And it means that water supply systems deliver an average of 70 percent of their output to users, compared to best practice delivery rates of 85 percent.*

The evidence points to deteriorating roads, bridges, ports, railroads and increased breakdown at power plants as a consequence of large cutbacks – 40 percent or more – in O&M expenditures because of budget stringencies. Kenyan hospital incubators, according to a World Bank (1993) study, operated for two years instead of the eight expected. Maintenance budgets in these hospitals had been reduced to only 1 percent of the machinery's value when the optimal was 10 percent.

And yet, at least from the World Bank perspective, rates of return on roads and other infrastructure such as irrigation can be very high. Moreover, hospitals, roads, power, irrigation, and water supply are all publicly provided goods for which it is fairly easy to recoup costs through excise taxes on fuel and vehicles (for roads) or user charges (for hospitals, power,

irrigation, and water). That being so, allowing their assets to deteriorate ironically hurts future government revenue potential.

Cutbacks in O&M spending simply postpone infrastructure spending into the future. It thus constitutes a means of protecting current consumption by shifting other expenditures across time to meet current cash deficit targets. Brazil, in 1998, is reported to have issued zero coupon government bonds that were not due until the following year in order to lower current year's interest expenditure.

#### **2.8.4 Payment Arrears**

There is also the popular expedient of resorting to delayed payments to government workers and suppliers. Such arrears lower the current year's cash deficit and explicit debt, but the accrual-based net worth balance is unchanged. The GFS Manual (1986) recommended cash rather than accrual accounting. Current practice uses a mixture of cash and accrual accounting. When arrears owed become a serious problem, the conventional approach to deficits in developing countries often shows arrears explicitly as a financing item for an accrual-based deficit target. This has been the CEPA approach. The GFS Manual (1996) recommended accrual accounting. Arrears, however, can still be used to temporarily meet a gross public debt target, since they are not included in the gross public debt.

Payments arrears accumulation is only one example of how the government can comply with a ceiling on visible liability accumulation (debt) by switching to hidden liability accumulation. Another is through switching from the granting of subsidies to SOEs to guaranteeing the bank loans made to the SOEs to cover their losses. This creates the appearance of a deficit reduction, but leaves unchanged the net worth definition of the deficit. When the SOEs default on their debt, however, the government pays off the debt and so ends up paying for SOE losses just as it had been when subsidies were explicit.

*Egypt phased out budgetary support to SOEs in 1991, but allowed loss-making SOEs to continue to operate on overdrafts and foreign loans. The Egyptian government periodically writes off the domestic debts of these SOEs (World*

*Bank, 1995). During the Gramm-Rudman period, the US Congress cut direct loans, reducing net lending and equity expenditure by \$50 billion. At the same time, however, it increased loan guarantees by \$178 billion, which did not show up under any expenditure item in the budget.*

### **2.8.5 Pension Fund**

Pension funds — that accumulate surpluses early in the life cycle of the plan — have often been loaned out to governments at negative real interest rates. The original Ghana SSNIT Law compelled the Trust to lend a specified amount— about 80% —of its net resources to government at 3 percent per annum. In one of the worst cases (Peru), the real return on the pension fund was negative 37.4 percent. Lower interest rates on government debt do reduce the budget deficit, but also reduce the reserves available to the pension plan when it begins to run deficits later in its life cycle. There are indications that without some changes in the employee and employer contributions, Ghana's SSNIT scheme is not viable. The government will have to honour net pension liabilities as the negative real interest rate scheme just redistributes spending across time.

Pension reserves have also been used to cover health costs of workers covered by social insurance programs— as with SSNIT's Trust Hospital. This can also help deplete reserves in the scheme. For example, the Venezuelan government invested between 10% and 30% of pension reserves in the hospitals of the social security system. In Ecuador, there was similar cross-subsidization of health programs with pension surpluses. Now these governments must face the rising expenditure on both health and pensions as the population ages with a depleted pension reserve fund.

Unfunded pension liabilities are a form of hidden liability accumulation. The GFS Manuals of the IMF treat social security taxes as revenue and social security spending as expenditure. Under such treatment the surplus of a young pay-as-you-go pension system directly reduces the budget deficit. But the NPV of the contribution and benefit scheme in place is often negative. Turkey,

Columbia, China and Argentina have a negative NPV of their pension plans equal to more than a third of GDP. And the present value of accrued claims by workers and pensioners in Brazil, Croatia, Hungary, Ukraine and Uruguay have been estimated to be 2 to 3 times GDP.

### **2.8.6 Revenue/Expenditure**

“There are many anecdotes of developing countries getting advance payments of taxes to meet IMF programme deficit targets”. By shifting revenues forward — as with the withholding tax — and postponing expenditures — as with cutbacks in O&M expenditures — governments can reduce current deficits at the cost of higher deficits in the future. Permanent deficit constraints, however, eventually bite in instances of pure shifting of revenue and expenditure. Temporary deficit constraints during BWI-sponsored adjustment programs therefore merely shift deficits into post-program periods. And even permanent deficit constraints can be evaded by running down assets and running up implicit instead of explicit liabilities.

Borrowing by off-budget agencies, whose debt the government guarantees is another way to accumulate hidden liabilities.

- In April 1998, the government of the Czech Republic announced that off-budget state agencies had accumulated debt equal to 13 percent GDP.
- In Ghana, TOR/VRA/ECG were found to have piled up about €2.5 trillion, equivalent to 9.2 percent GDP during election year 2000 as hidden subsidies with implicit guarantees from the government and/of the Bank of Ghana.

### **2.8.7 Summary**

The overriding conclusion from empirical evidence is thus stated as follows:

*Compliance with imposed fiscal rules has often led to cuts in public investment, accumulation of payment arrears, proliferation of creative accounting practices, and*

*recourse to one-off measures (such as privatisation receipts). Fiscally irresponsible governments create illusions of compliance when faced with externally imposed constraints that are binding.*

## **2.9 Special Report on Petroleum Products Pricing Policy <sup>11</sup>**

### **2.9.1 The Automatic Price Adjustment Formula**

The final retail (ex-pump) price of the typical petroleum product is determined by the following key factors:

- the dollar price of crude oil on world markets;
- the exchange rate;
- government taxes and levies;
- processing fees; and
- distributors'/marketers' margins.

The basic principle that has been implicit in agreements reached with the IMF in the ESAF/PRGF Arrangement is for the ex-pump price to fully reflect changes in any of these factors, especially the first two. The rationale is to avoid saddling the producers/suppliers of petroleum products, especially the Tema Oil Refinery (TOR) — the main supplier — with undue losses that would lead to debt, supply interruptions or both. This injunction to avoid subsidies has been rationalised on a number of considerations: from pollution of the environment and OPEC pricing policy, to the need to increase efficiency in use, contain demand pressure, and the implications of the size of the oil import bill for the balance of payments.

Notwithstanding these considerations, the ex-pump prices of petroleum products remained unchanged for almost a year in the face of a rapidly depreciating cedi and a tripling of oil prices in world markets, thus constituting an unfunded subsidization of consumption of these products. As a result TOR was left with a debt of ₵2.5 trillion equivalent to 9.2 percent of GDP at the end of year 2000, almost half of it owned to two banks. Furthermore, the huge financial losses and

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*11 CEPA is grateful to the Ministry of Energy for making vital information available for this special report.*

debts incurred by TOR also led to supply interruptions due to the company's inability to pay promptly for crude oil deliveries.

The new administration considered this state of affairs unsatisfactory — threatening the very existence of TOR and the solvency of the major bank involved. At the same time it considered the social and political consequences of the needed corrective discrete jump in prices and concluded that caution was the better part of valour. It therefore decided to employ a step-by-step approach.

The first step was to halt the process of increasing indebtedness of TOR. In fact, there was no choice in the matter, as the creditors could no longer provide any further credits. Government finances were in such a parlous state that the issue of the government taking over the funding of the subsidy was, simply put, not a feasible option.

The February 2001 price increases averaging about 52 percent required the removal of all government taxes — both ad valorem and specific. Apparently the inclusion of these would have raised prices by 75 percent, i.e. by a further 23 percent on average.

Given the high aid-dependence of the Ghanaian economy and the large unfunded deficit in the Budget for the 2001 fiscal year — which is expected to be mostly financed from debt relief and exceptional concessionary aid inflows — however, the loss of government revenue, though understandable and justifiable in the circumstances was, nonetheless, judged unacceptable over the medium-term. This is because it could compromise the policy objective of lowering the domestic debt/GDP ratio, bringing down the rate of inflation and with that the lending rate of interest charged by banks.

Since the Interim Budget passed by Parliament subsequently in March 2001 did not lead to a further upward revision of petroleum product prices, it may be presumed that Parliament had sanctioned the removal of taxes implied in the February prices. One of the prior actions stipulated in the Poverty Reduction and Growth Facility (PRGF) Arrangement with the IMF in June 2001 was to obtain Parliamentary approval for the implementation of an automatic

petroleum price adjustment formula with specified properties. Key among these properties is the restoration of taxes — 15 percent ad valorem component on the ex-refinery price and an average specific tax of ¢199 per litre — to enable the Budget to recover the revenue losses. The formula itself was to be installed no later than September 1, 2001.

In compliance the Ministry of Energy came out with a petroleum products pricing policy with the following features:

- the principle of full cost recovery of all outlays made to procure, refine, transport, and market petroleum products;
- use prices to raise revenue for government in accordance with Act 544 (1998) as amended by Act 577 (2000) and Act 593 (2001); and
- ensuring that ex-pump prices are uniform throughout the country.

In view of the above considerations we have the formula

$$\text{Ex-Pump Price} = \text{Ex-Refinery Price} + \text{Gov't taxes/levies} + \text{Marketing/Distribution Margins}$$

The determinants of these three broad components of the ex-pump prices are discussed below.

### ***Ex-Refinery Price***

For transparency and effective monitoring, the ex-refinery price may be taken to be the “the import parity price plus a ‘K’-factor mark-up that would have been previously agreed between TOR and the Government”.

$$\text{Ex-Refinery Price} = \text{Import Parity Cost} + K$$

#### *The “K”-factor Markup*

The mark-up, to be agreed annually but expected to not exceed “10 percent of the import parity, will be used, among other things, to effect cross-subsidy in the ex-refinery prices”. For the moment the ‘K’-factor has been set at zero for all products.

#### *Import Parity Cost*

The import parity cost can be represented by the following equation:

$$\text{Import Parity Cost} = \text{CIF} + \text{Related Charges}$$

where *CIF* is the c.i.f. dollar price of the product per metric ton.

The related charges (*rc*) comprise ocean or in-transit losses, inspection charges, harbour dues, letter of credit (LOC) costs, demurrage, financing cost, and distribution costs — in respect of storage and distribution to decentralized depots — which enable the institution of uniform prices countrywide. The total of all these related charges has been estimated at 10.2 percent of *CIF* for all products except LPG, which is estimated at 8.51 percent of *CIF*. Consequently, the import parity cost can be represented as follows:

$$\text{Import Parity Cost} = (1+rc)\text{CIF}$$

where *rc* = 8.51 percent for LPG and 10.20 percent for the other products.

The ocean or in-transit losses vary with the volatility of the product. The accepted international practice, however, is a uniform 0.5 percent of *CIF* for all products except LPG, which is 1.0 percent of the *CIF* value. Distribution to the decentralised depots incurs costs equivalent to 2.19 percent of *CIF* by all except LPG which is zero. The net difference in costs on account of these two components of related charges is 1.69 percent of *CIF*, which explains the difference between the total related costs of 8.51 percent of *CIF* in respect of LPG and  $(8.51+1.69)=10.20$  percent of *CIF* in respect of all others.

### ***Government Taxes and Levies***

These comprise an ad valorem excise duty, a specific excise duty, and a miscellany of levies that include the Road Fuel levy, the Hydrocarbon Exploration levy, the Strategic Reserve/Buffer Stock levy, and the Energy levy.

#### ***Ad Valorem Excise Duty***

The *ad valorem* duty on petroleum products was introduced on February 18, 1998 by Act 544 on the following petroleum products: premium petrol, gas oil, kerosene, residual fuel oil (RFO), and LPG. The duty was the equivalent of 15 percent of the ex-refinery price of the affected products. On February 23, 2001 this duty was repealed by Act 593, 2001 as part of the petroleum price restructuring initiative by the NPP Government. Although the repeal had a moderating effect on the ex-pump price, it also resulted in revenue losses to government. It was restored on August 17, 2001 (Act 603, 2001) to enable the Budget recover some of the earlier revenue losses.

#### *Specific Excise Duty*

The *specific duty* varies by product. It is a fixed tax imposed on each litre of petroleum products sold. In Act 544, 1998 the duty was levied on three products at the following rates: premium petrol at ¢90/litre; gas oil at ¢70/litre; and RFO at ¢25/litre. It was repealed on February 23, 2001 by Act 593, 2001. However, there are indications that it could be restored before the end of year 2001 at new rates averaging ¢199 per litre.

#### *Road Fuel Levy*

The *Road Fuel* levy is assessed on a per litre basis and is applicable to premium petrol and gas oil only. The levy constitutes part of the monies of the Road Fund established under the Road Fund Act (Act 536, 1997). It is collected by CEPS for submission to the Road Fund Board. On February 18, 1998 (Budget Statement, 1998) it was set at ¢150/litre and later increased to ¢230/litre on March 7, 2000 under Act 577, 2000. The new rates were finally implemented on February 23, 2001 after a delay of 2 years.

#### *Hydrocarbon Exploration Levy*

This levy is imposed on every litre of the following products: premium petrol, gas oil, kerosene, and residual fuel oil (RFO). The purpose of the hydrocarbon exploration levy is to provide monies to

- a) promote exploration of hydrocarbon basins;
- b) store geological data on hydrocarbon deposits in Ghana; and
- c) assist with human resource development in hydrocarbon exploration.

### *Strategic Reserve/Buffer Stock Levy*

This is levied on the same set of products affected by the hydrocarbon exploration levy. Its purpose is to finance reserve stocks of petroleum products and to establish and expand the network of strategic storage depots provided under the Energy Commission Act (Act 541, 1997). A targeted strategic stock level of 6 weeks for the products involved was deemed adequate at the time of the Budget presentation to Parliament in February 1998.

### *Energy Levy*

It is also imposed on the four products specified above. The energy levy constitutes part of the Energy Fund established under the Energy Commission Act (Act 541, 1997).

### *Marketing/Distribution Margins*

These payments, which vary by product type, accrue to the marketing Oil Companies and their agents as compensation for transporting the products from the centralised depots to the various retail points. They also include margins for the dealers and marketers of petroleum products. Except for LPG, these margins have not been revised since December 11, 1999 and demands for increases by the marketing companies remain considerably strong. Thus far, these demands have been resisted by government from considerations of the pass-through cost consequences for inflation and inflationary expectations. The implications for the smooth delivery of petroleum products countrywide can be potentially destabilising if not handled properly. For instance, in year 2000 it resulted in rampant sporadic shortages.

### *The Operational Ex-Pump Price Formula*

Putting it all together for all products we have a generic operational price build-up formula for the ex-pump price (*EPP*) given by

$$EPP_{it} = (1 + av_t) \{ E_t (1 + rc_{it})(CIF_{it}/cf_i) + K_{it} \} + sp_{it} + levies_{it} + margins_{it}$$

where

$E$	=	nominal exchange rate (cedis/US dollar)
$CIF$	=	dollar price of the product per ton (reference FOB Rotterdam of FOB Mediterranean)
$cf$	=	conversion factor, i.e. the specific gravity (litres/ton)
$av$	=	the ad valorem duty rate (% of the ex-refinery price)
$sp$	=	fixed specific duty per litre
$rc$	=	related charges (%CIF)
$K$	=	the mark-up factor to effect cross subsidy

The subscripts  $i$  and  $t$  denotes, respectively, the type of petroleum product and the effective implementation date of any policy change in the variable/parameter involved.

Currently,  $K=0$  for all products. Also as of August 17, 2001, the specific duties that were repealed during the price restructure in February 23, 2001 had still not been restored, i.e.  $sp=0$ . . Table 3.8 shows the historical developments in the other major discretionary parameters since April 19, 2000.

### ***Operational rules of adjustment of the Ex-Refinery Price***

Assuming given Government taxes and levies as well as other imposts and marketing/distribution margins, then the ex-pump price will fluctuate with the ex-refinery price which, in turn, will also fluctuate with the import parity price and/or the nominal exchange rate.

In order to avoid excessively frequent changes in ex-refinery prices, which would be disruptive in markets for goods and services in the economy, ranges are provided for these fluctuations, the end points of which serve as trigger points.

- a) import parity prices:  $\pm 2.5$  percent band;
- b) exchange rate:  $\pm \text{¢}50$  change in the cedi/US dollar rate
- c) combined effect registering an absolute change of  $\text{¢}10$  minimum compared to the

prevailing ex refinery price.

In operational terms, the trigger points for adjusting ex-refinery prices have been simplified as follows:

- absolute change in the CIF price = US\$5 per metric ton
- absolute change in exchange rate = ¢50 per US dollar
- combined effect of the two above such that the absolute change in ex-refinery price = ¢10 per litre (minimum)

These trigger points are subject to periodic reviews.

		Ad Val Duty	Specific Duty	Road Fuel Levy	Energy Fund Levy	Exploration Levy	Stock Fund Levy	Margins	Related Charges (% CIF)	Conv. Factor (Lit/mt)
<i>Currently being debated</i>	Premium	15%	200.00	230.00	5.00	3.00	30.00	186.66	10.20%	1379
	Gas Oil	15%	200.00	230.00	5.00	3.00	30.00	186.66	10.20%	1187
	Kerosene	15%	100.00	0.00	5.00	3.00	30.00	226.00	10.20%	1328
	LPG	15%	100.00	0.00	0.00	0.00	0.00	550.00	8.51%	1000
<b>17-Aug-01</b> <i>Act 603, 2001</i>	Premium	15%	0.00	230.00	5.00	3.00	30.00	186.00	10.20%	1379
	Gas Oil	15%	0.00	230.00	5.00	3.00	30.00	186.00	10.20%	1187
	Kerosene	15%	0.00	0.00	5.00	3.00	30.00	226.00	10.20%	1328
	LPG	15%	0.00	0.00	0.00	0.00	0.00	550.00	8.51%	1000
<b>23-Feb-01</b> <i>Act 593, 2001</i> & <i>Act 577, 2000</i>	Premium	0%	0.00	230.00	5.00	3.00	30.00	186.00	10.20%	1379
	Gas Oil	0%	0.00	230.00	5.00	3.00	30.00	186.00	10.20%	1187
	Kerosene	0%	0.00	0.00	5.00	3.00	30.00	226.00	10.20%	1328
	LPG)	0%	0.00	0.00	0.00	0.00	0.00	550.00	8.51%	1000
<b>19-Apr-00</b> <i>Act 544, 1998</i>	Premium	15%	90.00	150.00	1.00	1.50	10.00	146.00	n/a	1379
	Gas Oil	15%	70.00	150.00	1.00	1.50	10.00	146.00	n/a	1187
	Kerosene	15%	0.00	0.00	1.00	1.50	10.00	203.77	n/a	1328
	LPG)	15%	0.00	0.00	1.00	0.00	0.00	347.00	n/a	1000

*Source: Ministry of Energy, Ghana Gazette, and Tema Oil Refinery*  
<sup>a</sup> Duties, levies and margins are in cedis/litre except for LPG which is in cedis/kg.

### **Operational rules of adjustment of the Ex-Refinery Price**

The build-up to the final retail/ex-pump price of petroleum products in Ghana is determined by three key factors: the ex-refinery price charged by the Tema Oil Refinery (TOR), government taxes and levies, and marketing and distribution costs incurred in transporting these products from centralised depots to the various retail points.

Conformity with the tax laws on petroleum products requires that all the taxes and levies approved by Parliament are reflected in the retail prices paid by consumers of such products. Secondly, the ex-pump prices should be consistent with all international agreements entered into and signed by the Government on behalf of Ghanaians.

Given Government taxes and levies, an appropriate pricing structure for petroleum products is one that ensures that all costs incurred in the procurement, storage, transportation, marketing and distribution of these products are fully recovered, i.e. there should be no subsidies whether implicit or explicit.

The current debate on petroleum products is focused on whether the time is ripe for lowering the prices at the pump in the light of prices developments of these products in international markets and the trigger points for adjusting TOR's ex-refinery prices in line with the automatic petroleum adjustment pricing formula.

The automatic pricing formula, to be instituted by September 1, 2001 as indicated in the Poverty Reduction and Growth Facility (PRGF) Arrangement with the IMF, was to have specific characteristics, which in CEPA's opinion, need to inform the present debate in a more objective manner devoid of partisan connotations.

Three events took place between February 23, 2001 — when the current ex-pump prices were announced — and August 17, 2001. First, the dollar CIF price of petroleum products declined by 15.2 percent. Secondly, the exchange rate applicable for the operations of TOR depreciated by 2.6 percent resulting in cedi CIF ex-refinery price decrease of 13.0 percent. And thirdly, Parliament, in June, amended the petroleum products tax law and re-introduced the 15 percent ad valorem tax on the ex-refinery prices.

If the automatic pricing formula was truly functional —in the sense of being consistent with the existing tax laws on petroleum products and Ghana's current international commitments, and if there are no implicit or explicit subsidies being borne by any of the actors involved in procuring, marketing, and distributing the products — then the decrease in ex-refinery prices should have

resulted in a reduction in ex-pump prices.

However, before August 17, the re-instatement of the ad valorem tax approved in June had not been implemented. The reduction in ex-refinery prices thus made it possible to implement the law for the restoration of the 15 percent ad valorem excise duty which was repealed in February to contain any potential cost-push inflation and inflationary expectations. Apparently, the decrease in the ex-refinery price allowed for the room needed to apply the 15 percent ad valorem tax without having to adjust the retail/ex-pump price set in February (see Table 2.9).

While the present ruling prices are now in compliance with the law they, nevertheless, are inconsistent with the current PRFG Arrangement with the IMF, which also calls for the restoration of specific taxes averaging ¢199/litre in addition to the 15 percent ad valorem tax no later than September 1, 2001. Conformity with this stipulation would require a minimum average increase of 9 percent over and above the current ex-pump prices of key petroleum products (see Table 2.9). On the other hand, to preserve the current ex-pump prices unchanged and still remain consistent with the PRGF programme, the ex-refinery price (comprising the exchange rate and the dollar CIF price) would have to fall further by about 12 percent.

Also, marketing/distributing margins for most of the products have not been revised since December 11, 1999. These margins are supposed to cover all costs incurred by the Oil Marketing Companies and their agents in respect of the transportation of the products from the centralised depots to the various retail points. Until the issue of an upward adjustment in these margins being requested by the actors involved is amicably resolved, it would be ill-advised to be talking about price reductions unless, of course, government is willing to make it up to the marketers/distributors from the Budget.

Furthermore, the recent signals from OPEC to reduce crude supplies, the expected higher demands for heating oil in respect of the Northern Hemisphere winter, and the anticipated seasonal depreciation of the cedi in the context of increased demand for imports for the 2001 Yuletide season could potentially induce price increases at the refinery level. Should these events materialise, Ghanaians may have to embrace, albeit with some pain, upward adjustments in ex-pump prices in response to the increases in ex-refinery prices so that TOR is not saddled with the

financial losses that threatened its viability in the past. Inappropriate pricing policies in the past resulted in huge financial losses to TOR which, at the end the 2000 fiscal year, stood at ¢2.5 trillion, equivalent to 9.2 percent of GDP.

	Based on Current Legal Structure	Based on Current PRGF Program	Actual **	%change from Actual	
	(a)	(b)	(c)	(a-c)/c	(b-c)/c
Premium Gas Oil	2,333.33	2,533.33	2,333.33	0.0%	8.6%
Kerosene	1,955.59	2,155.59	1,955.56	0.0%	10.2%
LPG	1,955.57	2,055.57	1,955.56	0.0%	5.1%
	2,200.02	2,300.02	2,200.00	0.0%	4.6%
All Products ***	2,702,861	2,946,520	2,702,861	0.0%	9.0%

\* In cedis/litre except LPG which is in cedis/kg  
 \*\* In effect since February 23, 2001  
 \*\*\* Volume-weighted average prices in ¢/m. ton

To conclude, the current call from certain segments of the population to reduce petroleum prices seems to be misplaced because the issues needed to make that decision have not been fully considered. Until the ex-pump prices that obtain are, simultaneously, in conformity with the law, are consistent with the current PRGF Arrangement agreed with the IMF, and are devoid of any subsidies (whether implicit or explicit), it would not be advisable to evoke the trigger clause of the automatic pricing formula when prices of petroleum products decline in world markets. This is because even though the September 1, 2001 deadline for instituting the automatic price adjustment formula has been met, the required set of specified features that would make the formula fully operational is still incomplete thus violating the spirit of the formula. In particular, the current ex-pump prices do not reflect the restoration of specific duties at average of ¢199 per litre as agreed with the IMF in June 2001. They also have not addressed concerns for increased

marketing margins from the Oil Marketing Companies and their agents. This last issue has important implications for the smooth delivery of petroleum products countrywide, which if not properly handled, can be potentially destabilising. For example, in the year 2000 it resulted in rampant sporadic shortages, which led to long queues at the pumps.

### **3. REVIEW OF MONEY, CREDIT AND BANKING**

#### **3.1 Introduction**

In 1997, the Bank of Ghana adopted a tough non-accommodating monetary stance, which with support from a boom in cocoa exports in 1998 was seemingly successful. This posture, which was welcomed, especially following a very accommodating election year of 1996, was however short-lived. Sadly by the close of the second term of the National Democratic Congress, monetary and economic indices were showing poor trends. The economic legacy bequeathed to the incoming government of the New Patriotic Party included a pile-up of domestic debt (including an unknown magnitude of payment arrears), rising inflation rates, high interest rates and a high growth in money stock.

#### **3.2 Monetary Management**

For the year 2000, as in the year before, the quest for price stability and arrest of the fast depreciating cedi were the main objectives of monetary policy. The Bank of Ghana instituted restrictive monetary policy with interest rate as the main instrument, complemented by an increase in the primary reserve requirement from 8 to 9 percent of deposits, and the enforcement of financial regulations, particularly those relating to dealings in foreign exchange.

As with other election years (1992 and 1996) the fiscal pressures were overbearing in 2000 for the monetary authorities, particularly following closely on the worst macroeconomic crisis Ghana has witnessed in recent times. Although the central bank continued to give the impression of a tough stance against government fiscal excesses through the dishonouring of government cheques, the year turned out to be one of massive monetary accommodation. The Government depleted its deposits at the central bank from 875 billion cedis at the beginning of the year to a zero balance by the end of July, and then the Bank of Ghana commenced the extension of overdraft to the Government. By the end of the year, a total overdraft of about 900 billion had

been extended to the Government. This caused the monetary authorities to renege on their

commitment to the IMF limiting them to a domestic financing of no more than 254 billion cedis. Significantly, the country had in June 2000 asked for a waiver from the IMF for tripping this very “performance criterion” at the close of the preceding year. In effect, the Bank of Ghana “printed” money to finance the fiscal deficit.

The impact of the monetary accommodation on *reserve money* (liquid liabilities of the central bank) was to push it to 2,150 billion cedis – about 17 percent above target. This compares unfavourably with the 1 billion cedis excess the year before for which the country had to ask for a waiver. An examination of available data from the Bank of Ghana reveals that control was lost on the reserve money target in the last quarter of the year 2000. Year-on-year, reserve money increased by about 35 percent, with potentially serious inflationary consequences.

The main push in the *reserve money* growth came from *currency outside the banks*, which jumped by 46 percent during the year. It is important to note that for the last quarter alone, about 644.1 billion cedis cash was pumped into the system. This may be due to the payment of cocoa farmers and contractors in the last quarter of the year. However, that was also the period most banks reported specie shortage.

The other component of reserve money, *bank reserves*, showed moderate growth. The aggregate reserve ratio of the deposit money banks showed a modal value of about 12 percent for the year. June 2000, however, presented an outlier when the reserve ratio fell to 9 percent, just a shade above the mandatory requirement. Investigations revealed that that might have happened as a result of a quick **Repo** by the central bank to prevent a possible tripping of an IMF financial benchmark. Significantly, this **Repo** activity resulted in the Reserve Money dropping by about 40 billion cedis in June alone. This **Repo** activity was reversed in July lending credence to the suspicion that the June activity was only done to beautify the books for reporting to the IMF.

In July, the central bank attempted to squeeze money supply further by increasing the primary reserve ratio from 8 to 9 percent. An increase in the reserve ratio squeezes excess reserves from the deposit money banks, thus limiting their ability to lend. This change in the reserves, however, had practically no effect on the money stock as the actual reserve ratio of the banks

remained unchanged leaving the money multiplier also unchanged. There was, however, an indirect impact on the rate of interest.

Reserve requirement on the banks include lodgings against their foreign currency deposits, which must be lodged in cedis. CEPA had earlier cautioned on the implication of this (Refer to the CEPA 1997 *Mid-Year Review* and 1998 *Macroeconomic Review and Outlook* for commentaries when this policy was introduced in March 1997). Banks with large foreign currency deposit holdings sometimes have to borrow cedis on the local market to make up for their reserve requirements. Since the banks borrow at high rates on the open market, they also bid for higher rates on their investments - hence the high rates on Treasury bills and Bank advances. The central bank may consider requiring the banks to keep reserves on the foreign currency deposits in the currencies concerned.

### **3.3 Developments in Money**

Growth in the stock of money for the year 2000 was a reflection of the expansionary fiscal policy and the liberal accommodation by the monetary authorities. Money supply increased by about 40 percent over the year, negating previous attempts at tight money during the early half of the year. Claims by the banking system on government more than doubled from about ₵2.8 trillion cedis at the beginning of the year to ₵4.5 trillion at the end of December 2000. But much of the increase was in the second half of the year, leading one to speculate on election pressures. There was also a large increase (57%) in credit to the private sector during the year. This, as CEPA has pointed out in earlier reviews, may be indicative of increased borrowings by the sector on account of high costs of forex due to the fast depreciation of the cedi, as well as continued “proxy borrowing” by Government in respect of new arrears being generated in the system.

<b>Table 3.1: Monetary Indicators</b>						
	<b>M2+ Growth Rates 1/</b>	<b>Growth in Reserve Money 2/</b>	<b>M2 Multiplier 3/</b>	<b>M2+ Multiplier</b>	<b>Currency - Deposit Ratio 4/</b>	<b>Foreign Currency - Deposit Ratio</b>
<i>Dec-98</i>	17.6%	16.4%	2.3	2.8	38.4%	23.8%
<i>Mar-99</i>	17.3%	16.0%	2.4	3.0	33.3%	24.3%
<i>Jun-99</i>	15.6%	14.9%	2.5	3.1	30.6%	24.8%
<i>Sept-99</i>	17.3%	22.2%	2.5	3.1	30.7%	25.3%
<i>Dec-99</i>	16.1%	13.1%	2.2	2.9	35.4%	29.0%
<i>Mar-00</i>	21.4%	18.8%	2.3	3.1	31.3%	30.2%
<i>Jun-00</i>	24.1%	17.7%	2.4	3.3	27.0%	34.5%
<i>Sept-00</i>	28.6%	18.3%	2.2	3.4	44.6%	73.2%
<i>Dec-00</i>	38.9%	35.8%	2.0	2.9	65.2%	71.3%

*Source: Computed from Bank of Ghana Statistical Bulletins*

Notes:  
 1/ & 2/ Represents year on year growth rates  
 3/ Money multiplier is defined as money (M2 & M2+) to high powered money ratio  
 4/ Deposits represents total cedi deposits (inclusive of foreign currency deposits)

The Net Domestic Assets (NDA) of the banking system expanded by 70 percent by the end of the year 2000, compared to the rather brisk rate of expansion of 96 percent in total domestic credit. This relatively moderate expansion in the NDA is due to the erratic behaviour of the miscellaneous item — Other Items Net (OIN) — in the consolidated balance sheet of the banking system. Specifically, during the year, the OIN declined sharply by almost 350 percent. Because of the way several components are lumped into the OIN, it is impossible to find out the actual components that had such moderating impact on the growth of the money stock.

On the uses side, after showing a decline in the first half of the year, currency with the non-bank public surged upwards by about 63 percent in the second half. This huge increase in *cash holdings* should normally act as a check on growth of money stock as it acts as a withdrawal in the money creation process. Nevertheless, it appears that the relative strength of the increase in the multiplier prevailed, leading to the large increase in the stock of money by the end of the year. Of course, the inflationary consequences of such dramatic changes in cash holdings are also notable.

Deposit holdings of the commercial banks did not increase very much. Cedi deposits increased only marginally while foreign currency deposits only increased in cedi terms by virtue of the sharp exchange rate depreciation. In sum, the large currency to deposit ratio plus the marginal changes in deposits point to a period of weak financial intermediation. Coupled with a very bearish capital market, 2000 can best be described as a period of financial crisis in Ghana.

<b>Table 3.2: Money Supply and its Sources (in billion cedis)</b>					
	<b>1999</b>	<b>Q2:00</b>	<b>2000</b>	<b>Second Half-Year Growth (2000)</b>	<b>Year on Year Growth (2000 on 1999)</b>
<b>Narrow Money</b>	2129.4	2182.7	2606.8	19.4%	22.4%
Currency	1186.1	1066.9	1739.1	63.0%	46.6%
Demand Deposits	943.3	1115.9	867.7	-22.2%	-8.0%
<i>Quasi Money</i>	1433.6	1486.4	1788.4	20.3%	24.8%
Savings Deposits	876.1	954.5	1099.2	15.2%	25.5%
Time Deposits	557.5	532.0	689.2	29.6%	23.6%
<b>Broad Money (M2)</b>	3563.0	36669.2	4395.2	19.8%	23.4%
Foreign Currency Deposits	970.5	1364.7	1943.2	42.4%	100.2%
<b>Broad Money (M2+)</b>	4533.4	5033.9	6338.4	25.9%	39.8%
<i>Sources:</i>					
<b>Net Foreign Assets</b>	110.1	128.0	-1167.8	-1012.3%	-1157.8%
<b>Net Domestic assets</b>	4423.3	4905.9	7506.2	53.0%	69.7%
<i>Net Domestic Credit</i>	5118.4	6716.2	9627.3	43.3%	96.8%
- Central Government	2159.4	2853.1	4536.2	59%	129.3%
- Cocoa financing	69.9	27.8	42.1	51.2%	-39.8%
- Other Public Sector	422.9	714.9	1213.3	69.7%	193.1%
- Private Sector	2466.3	3120.3	3835.7	22.9%	57.9%
Other Items (Net)	-695.1	-1810.3	-2121.1	17.2%	353.3%
<b>Total Assets</b>	4533.4	5033.9	6338.4	25.9%	39.8%
<i>Source: Bank of Ghana Monthly Statistics Bulletins</i>					

### **3.4 Developments in Prices**

There was pressure on the general price level to rise throughout the year. There were cost push pressures emanating from the depreciating exchange rate as well as demand pressures from the fiscal excesses and the consequent monetary accommodation.

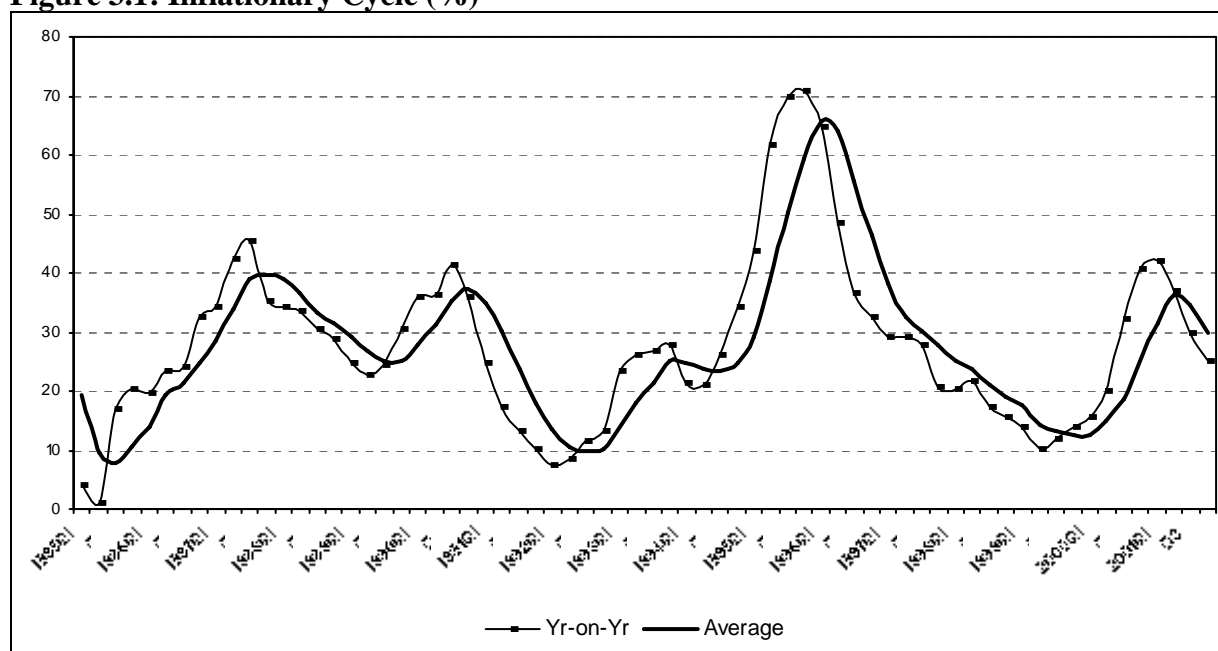
In its 1998 Ghana Macroeconomic Review and Programme, CEPA had illustrated how the inflationary trend in Ghana mimics a three-year business cycle. CEPA had argued among other things that the three-year inflation cycle is consistent with what has been observed for both output performance and changes in the stock of money. Earlier publications (See Sowa's "Governance and Economic Performance in Ghana" in *African Journal of Economic Policy*, 1996) have alluded to the strong correlation between Ghana's political history, economic performance and the business cycle. The author observed that changes or near changes in governments (e.g. attempted coup d'états) occur at the peak of the inflation cycles, and that the year of change is usually characterized by severe decline in economic performance.

The fact that inflation was at its lowest ebb in January 1992 may have aided the transition from the non-democratic PNDC rule to democratic governance led by the NDC. Although the seemingly positive economic situation gauged by the rate of inflation may have helped to retain virtually the same regime, it later proved to be unpropitious as inflation began to rise soon afterwards. This set people wondering whether strong adjustment policies could survive pluralistic governance. A brief stability in 1994 was followed by a price hike ending with an inflation of about 70 percent in 1996. It is important to recognize that excess outlays associated with the elections appear to have given the inflationary spiral a strong impetus. Fortuitously, "stolen verdict" or not, statistically engineered or not, the NDC officially enjoyed falling prices till a new trough was established at the beginning of 2000.

Election year 2000 was a tough economic year – rising prices, depreciating exchange rate, high interest rates, and declining output. By the end of 2000, inflation had completed another peak-to-peak cycle and was ready for a descent. However, the NDC did not survive the election after taking the country through a severe crisis beginning from mid-1999 into the new millennium.

By the end of the year 2000 inflation had hit a year-on-year peak of 40 percent and an annual average of about 25 percent.

**Figure 3.1: Inflationary Cycle (%)**



Although non-food inflation appeared to have contributed more (26.1%) of the overall end of December 2000 inflation of 40.5 percent, the rate of change of food inflation was almost six-fold compared to the doubling of the former. Non-food inflation commenced the year with higher rates of inflation on account of the steep depreciation of the exchange rate carried over from 1999.

In the non-food category, the rate biggest push was from “household goods and services” and “clothing and footwear” sub-sectors. The rapidly depreciating exchange led to a 78.3 percent and a 57 percent increase, respectively, in these sub-sectors. For the last quarter alone the price change in these categories were 12.3 percent and 17.9 percent, respectively. “Transport and communication”, another sensitive sub-sector in the non-food category rose by 47.3 percent during the year but showed a relatively moderate increase of 3.4 percent over the last quarter of the year. It is clear that if government had tried to lift the subsidies off fuel, the price level for this sector would have shown a bigger jump and would have possibly triggered spiral inflation. However, the subsidies and the consequent fiscal and monetary effects affected the rate of inflation all the same.

	<b>Food</b>	<b>Non-Food</b>	<b>Year on Year</b>	<b>Average</b>
<i>Dec-99</i>	6.6	20.8	13.8	12.4
<i>Jan-00</i>	4.6	23.7	14.3	12.4
<i>Feb-00</i>	5.6	24.0	14.9	12.4
<i>Mar-00</i>	7.0	23.8	15.6	12.6
<i>Apr-00</i>	8.7	26.0	17.5	13.2
<i>May-00</i>	7.8	29.3	18.7	14.0
<i>Jun-00</i>	6.8	32.6	19.8	14.9
<i>Jul-00</i>	7.7	36.1	22.1	15.7
<i>Aug-00</i>	10.9	41.4	26.6	17.0
<i>Sep-00</i>	15.6	47.3	32.3	18.7
<i>Oct-00</i>	20.2	52.4	37.4	20.8
<i>Nov-00</i>	23.2	53.4	39.5	22.9
<i>Dec-00</i>	24.3	54.2	40.5	25.2
<i>Jan-01</i>	26.3	52.9	40.9	27.3
<i>Feb-01</i>	27.4	50.5	40.1	29.4
<i>Mar-01</i>	26.7	54.5	41.9	31.6
<i>Apr-01</i>	24.7	51.6	39.5	33.5
<i>May-01</i>	24.4	48.7	37.9	35.1
<i>Jun-01</i>	25.7	45.5	36.8	36.4

*Source : Ghana Statistical Service*

We have explained earlier how the poor state of the economy exemplified by the high inflationary situation may have contributed to the demise of the government of the NDC. Figure 1 also shows that beginning 2001 inflation was on a downward trend. The new government, riding of the good side of this “natural” inflation-cycle, as well as the goodwill of Ghanaians and the international donor community yearning for a “positive change”, implemented some tough policies which the previous government had pussy-footed on.

Prices of petroleum products and utilities were increased without translating into price hikes likely to worsen the inflationary situation. The prices of petroleum products were increased by 67 percent in February followed in May and June by increases in the prices of Electricity and Water by 100 and 96 percent, respectively. In the interim, the minimum wage rate was increased in May by 31 percent from ₵4200 to ₵5500 per day. These price changes did not appear to have impacted adversely on the general price level. It is possible that the general public was carrying on in the euphoria of the “positive change” in government. It is in deed on record that a section

of traders, particularly those dealing in spare parts, decided to lower their prices in support of the change in government.

But, caution is called for here. The good wind driving the inflation spiral downwards runs out about the middle of 2002. The bad wind of the excessive monetary injection of the last quarter of 2000 will, however, be still lurking in the system. Further, fiscal pressures are likely to be severe as the general public cries for a more concrete demonstration of a “positive change” in their pockets. This is against the background that recent world developments point to a recession in the developed world, which is likely to negatively impact on export proceeds. In sum, Ghanaians should brace themselves for a rising level of inflation from the middle of 2002. The government should commence prudent fiscal management now, to mitigate any negative developments in 2002.

### 3.5 Developments in Banks and Interest Rates

Most banks in Ghana showed impressive performance for 2000, even as the national economy tottered. See table 3.6. Huge borrowing by government and the consequent high Treasury bill rates provided lucrative investment avenue for the banks. Nine out of the 14 banks existing in 1999 made over 100 percent gains in profit-after-tax by the close of 2000. Of the remaining banks, apart from the Merchant Bank (Ghana) Limited, all made modest gains over their previous year’s profit-after-tax.

Although the banking industry on the whole appears healthy the rise in the non-performing loans to total loans ratio gives cause for worry. The worsening of this solvency index has necessitated a huge provision for bad debt by the two biggest banks – Ghana Commercial Bank and the Standard Chartered Bank. This poor situation is not unrelated to the debt of the Tema Oil Refinery (TOR).

<b>Table 3.4: Performance Ratios of the Banking Sector</b>						
	1995	1996	1997	1998	1999	2000
<b>SOLVENCY</b>						

<i>Non-Performing Loans to Total Loans</i>	3.5	5.6	3.2	1.9	2.6	6.9
<i>Working Capital to Total Assets</i>	13.2	12.7	13.7	13.5	14.4	10.7
<b>PROFITABILITY</b>						
<i>Operating Expenses to Total Assets</i>	6.5	6	6.8	7.1	6.2	5.5
<i>Interest Income to Total Assets</i>	8.6	9.1	9.9	10.2	8.6	8.9
<i>Non-Interest Income to Total Assets</i>	8	6.1	6.3	4.8	5.4	6.6
<i>Profit-after-tax to Total Assets</i>	6.8	5.5	5.8	4.9	4.7	6.0
<b>FINANCIAL INTERMEDIATION (%)</b>						
<i>Credit to private sector to GDP growth</i>	5.3	6.4	8.1	9.9	12.0	14.1
<i>Broad Money to GDP</i>	17.9	17.5	18.1	19.1	17.3	16.2
<i>Central Bank Credit to banks to GDP</i>	89.7	78.4	23.1	66.8	53.8	56.8

As usual, the commercial banks performed much better than the merchant and development banks. Aside from the fact that the service sector and specifically commerce is the most active sector, and the preferred clients for banks because of its quick turnover, a lot of the gains by the commercial banks is related to the structure of interest rates and interest spreads in Ghana. Generally, cost of savings mobilization is low for the commercial banks compared to the others. Small depositors are offered paltry interest on their savings while big depositors manage to negotiate for higher rates on their deposits. Thus, a commercial bank is more likely to incur lower interest expense on its deposits than a development or merchant bank. Nevertheless, banks such as Standard Chartered, Barclays, and SSB, which discouraged small depositors and went after big depositors, may have incurred higher interest expense by the same argument.

On the lending side, big borrowers again negotiate for better rates and hence reduce the interest income of merchant and development banks in relation to commercial banks. Thus, on the whole, net interest income will be comparatively higher for banks with small depositors (commercial banks) than those with big depositors.

<b>Table 3.5: Market Shares 2000/1999</b>				
	<b>Assets</b>	<b>Deposits</b>	<b>Advances</b>	<b>Investments</b>

	1999	2000	1999	2000	1999	2000	1999	2000
<b>Commercial Banks</b>								
Standard Chartered	23.7%	25.6%	28.7%	19.7%	23.6%	27.7%	21.2%	19.0%
Ghana Commercial	17.9%	18.4%	17.3%	22.3%	18.8%	22.0%	22.3%	24.0%
Barclays	14.0%	14.1%	11.6%	17.7%	17.8%	10.3%	15.8%	18.3%
Social Security	11.0%	9.9%	10.8%	9.2%	11.2%	10.4%	12.4%	10.4%
Agricultural Development	10.0%	10.5%	13.2%	7.0%	5.2%	11.6%	6.8%	10.9%
National Investment	3.0%	2.3%	3.4%	1.7%	2.5%	2.6%	2.4%	2.3%
Trust	2.0%	2.2%	1.7%	2.4%	2.5%	1.8%	1.8%	2.5%
Prudential	0.9%	0.9%	0.8%	1.1%	1.0%	0.7%	1.0%	1.3%
Metropolitan & Allied	0.8%	0.7%	0.8%	0.6%	0.6%	0.0%	0.6%	1.1%
International Commercial	0.5%	0.4%	0.2%	0.4%	0.4%	0.1%	0.8%	1.0%
Amalgamated Bank		0.1%		0.1%		0.0%		0.1%
<b>Merchant Banks</b>								
ECOBANK	6.8%	6.8%	3.8%	8.8%	7.8%	6.0%	5.7%	3.0%
Merchant	5.7%	4.4%	5.1%	5.2%	6.1%	4.2%	6.0%	2.7%
CAL Merchant	2.3%	1.9%	1.6%	1.7%	1.4%	1.5%	1.8%	1.9%
First Atlantic	1.4%	1.4%	1.0%	1.7%	1.1%	0.7%	1.5%	1.2%
Stanbic Bank		0.5%		0.4%		0.2%		0.4%

The summary of the balance sheets of the banks in Table 3.5 shows that “small can be beautiful”. There is a lot to justify why banks prefer bigger customers to smaller ones. The principal argument relates to economies of scale. Generally, unit cost of banking is lower for a bigger customer than for a smaller customer. It will probably take the same time to process a 1 million cedi loan, as it would take to process a 1 billion cedi loan. However, when the big fall, they fall big.

For the year 2000, “bad” lending to the Tema Oil Refinery took a big toll on the Standard Chartered Bank and the Ghana Commercial Bank, as these banks were forced to make huge “provisions for bad debts”. As a result, Standard Chartered lost its place in the first position as the best performing bank. GCB, however, in spite of the huge provision managed to climb to first position on the back of “small” clients. (Table 3.5 shows the Stanchart losing a huge chunk of their share of deposit taking to the GCB). As the former threw away small customers, the latter

picked and nurtured them with small “guaranteed” facilities. Workers who manage to get guarantees from their work places are offered easy personal loans by GCB. Recovery on these loans is virtually 100 percent. Small can, in deed, be beautiful.

Another big income earner for the banks was “commission and fees”, representing charges of various kinds that are imposed on clients. Such charges include penalties for having account balances below the stipulated minimum, charges for processing loans and advances, as well as charges for other bank services such as processing of bank drafts.

**Table 3.6: Balance Sheets and Profit and Loss Accounts of Ghanaian Banks (2000) (in ₵ billion)**

	<i>ADB</i>	<i>ABL</i>	<i>BBG</i>	<i>CAL</i>	<i>EBG</i>	<i>FAMBL</i>	<i>GCB</i>	<i>ICB</i>	<i>MBG</i>	<i>MAB</i>	<i>NIB</i>	<i>PBL</i>	<i>SCB</i>	<i>SSB</i>	<i>SB</i>	<i>TTB</i>	<i>ALL BANKS</i>
Cash and Short Term Funds	287.8	2.7	655.9	87.9	418.5	31.1	438.7	17.3	194.2	8.1	70.6	36.2	262.3	337.9	5.3	33.6	<b>2888.0</b>
Investments	314.7	1.5	529.2	53.9	85.1	34.8	692.8	29.8	77.1	30.3	67.6	36.3	549.1	299.5	11.4	71.4	<b>2884.7</b>
Advances	540.3	1.5	479.6	69.6	281.0	34.7	1020.2	3.6	195.2	1.0	122.6	34.3	1287.0	484.4	8.2	81.5	<b>4644.8</b>
Other Assets	124.1	0.7	43.1	11.0	27.0	1.1	50.0	1.0	20.8	0.4	11.1	1.7	939.7	55.1	2.6	12.5	<b>1302.1</b>
Fixed Assets	18.7	1.4	26.0	12.9	29.4	3.4	54.5	1.6	46.2	2.9	9.3	3.9	97.3	39.3	5.3	4.4	<b>356.6</b>
Total Assets	1285.7	8.8	1735.5	235.4	841.2	172.3	2256.3	53.3	537.4	84.1	281.3	112.4	3149.6	1217.2	56.3	264.8	<b>12291.6</b>
Deposit & Current A/c	533.3	5.3	1344.4	132.6	667.1	127.3	1693.3	29.3	399.2	49.4	128.8	80.1	1499.4	702.5	28.4	185.3	<b>7605.6</b>
Creditors & Accruals	179.6	0.7	237.8	34.3	90.6	23.8	280.8	7.4	20.2	7.5	54.0	14.3	1339.2	262.3	3.2	14.0	<b>2569.8</b>
Borrowings		0.0	0.0	31.7	1.3	0.9	55.1	0.0	33.9	0.4	19.6	10.1	68.9	46.0	2.7	41.4	<b>312.0</b>
Long-Term Borrowings	340.4	0.0	0.0								1.4			34.8	9.0		<b>436.3</b>
Total Liabilities	1053.4	6.1	1588.4	200.6	771.6	162.7	2029.1	36.7	453.3	77.2	203.8	104.8	2958.1	1048.6	43.3	241.6	<b>10979.2</b>
Stated Capital	7.7	4.2	1.0	3.2	18.2	2.0	20.0	10.0	5.0	2.7	3.3	2.3	2.6	6.7	16.0	10.0	<b>115.0</b>
Capital Surplus		0.0	1.3	4.9		3.7	3.9	40.2	1.7	1.7			10.2	16.5	0.9	9.1	<b>94.1</b>
Income Surplus	224.6	-1.4	111.8	26.7	51.4	4.8	203.3	2.7	38.9	2.5	72.5	5.2	178.6	145.1	-3.6	4.2	<b>1067.3</b>
Shareholders Funds	232.3	2.8	147.1	34.8	69.6	9.6	227.2	16.7	84.1	6.9	77.5	7.5	191.4	168.6	13.1	23.3	<b>1312.4</b>
Tot. Liabilities + Shareholders funds	1285.7	8.8	1735.5	235.3	841.2	172.3	2256.3	53.3	537.4	84.1	281.3	112.4	3149.6	1217.2	56.3	264.8	<b>12291.6</b>
Earning Assets	855.0	3.0	1008.8	123.5	366.1	69.5	1713.0	33.5	272.4	31.3	190.2	70.6	1836.1	783.9	19.6	152.9	<b>7529.5</b>
Interest Income	152.4	0.5	277.6	36.2	99.6	26.7	361.1	10.7	89.0	19.6	43.6	20.5	386.4	247.8	8.2	42.3	<b>1822.4</b>
Interest Expense	55.3	0.3	80.0	17.4	39.6	18.4	128.8	3.2	57.8	9.8	20.5	12.4	190.6	74.0	2.5	22.3	<b>733.0</b>
Net Interest Income	97.1	0.2	197.7	18.8	60.0	8.3	232.3	7.5	31.1	9.8	23.2	8.1	195.8	173.8	5.6	19.9	<b>1089.4</b>
Commission & Fees	65.5	0.5	89.2	13.9	53.4	4.1	129.0	0.8	18.2	2.8	9.9	3.7	57.2	51.5	3.9	7.4	<b>511.1</b>
Other Income	5.5	0.0	8.4	8.1	0.1	4.4	109.4	0.3	38.0		60.0	3.9	50.7	9.2	0.5	5.7	<b>304.4</b>
Non-Interest Income	71.0	0.5	97.6	22.1	53.6	8.5	238.5	1.2	56.1	2.8	69.9	7.6	107.9	60.7	4.4	13.1	<b>815.6</b>
Total Income	168.2	0.7	295.2	40.8	113.6	16.8	470.8	8.7	87.3	12.7	93.1	15.7	303.8	234.5	10.0	33.0	<b>1905.0</b>
Provision for Bad Debts	44.4	0.0	9.9	0.2	4.1	1.5	98.9	1.0	22.7	1.8	26.3	0.6	90.9	17.6	0.1	1.2	<b>321.1</b>
Operating Expenses	63.5	2.1	94.9	17.2	40.0	10.4	143.9	4.0	26.3	9.3	21.7	10.4	117.5	91.8	8.8	15.6	<b>677.5</b>
Profit before tax (after extraordinary item)	130.0	-1.4	190.5	23.4	69.6	4.9	177.6	3.7	19.9	1.6	44.2	4.7	151.5	125.2	1.1	16.2	<b>962.7</b>
Profit after Tax	100.0	-1.4	127.8	15.2	42.6	3.6	138.6	2.4	12.9	1.6	43.3	3.1	115.2	77.2	1.1	10.5	<b>693.8</b>

Source: Published Bank Accounts in the Newspapers, March 2001

### **3.6 Developments in the Treasury Bills and Bonds Market**

Currently, the sale of Treasury bills and bonds appears to be predominantly determined by monetary policy considerations. Thus, in order to achieve the “preferred” interest rate structure, quantities of sale of the active instruments – 91-day Treasury bill, 182-day Treasury bill and the 1-year Note - are appropriately adjusted. In the first quarter, the shorter dated Treasury bills - 91-day and 182-day - were the dominant OMO instruments with total net sale of c4,435 billion compared with 480 billion of 1-year Notes.

There was, at the same time, a net repurchase of c4,121 billion of Bank of Ghana money market instruments - a source of liquidity injection. In the second quarter the Bank of Ghana repurchased a further 460 billion of its own money market instruments.

But the significant difference between developments in the second quarter and the first was the switch in roles of the government instruments. About c460 billion of 91-day Treasury bills were repurchased even as there was a net sale of about c4,170 billion of the 1-year Note. Thus there was a net repurchase of the shorter dated instruments. The outcomes of these net repurchases at the shorter-end of the market are supply shortages and relative increases in the prices of these instruments. Correspondingly, interest yields on these Treasury bills continued to fall over the period. The discount rate on the 91-day Treasury bill, for example, fell by 4.9 percentage points in the second quarter and by a cumulative 7.9 percentage points for the half year.

In CEPA’s view the fiscal targets set in the ESAF programme are unrealistically tight. However, as long as the Bank of Ghana retains discretionary authority over the monetary and public finance uses of the Treasury bills and bonds, it can impose whatever fiscal discipline it needs for the attainment of its monetary stance by simply refusing to pay government bills. The sustainability of this process depends on both internal and external borrowing options available to private suppliers of goods and services to government. Such suppliers are currently saddled with mounting claims (payment arrears) on government.

### **3.7 Stock Market Developments**

November 2000 marked the tenth year of Ghana's stock market. From 11 listed companies and 1 government bond in 1990, the market currently has 22 listed companies with 5 corporate bonds. Market capitalization has steadily increased from ₵30.46 billion to ₵3.7 trillion likewise the GSE-Index which has risen from 70.25 to 857.89 over the ten year period. Thus, the stock market's contribution to the economy in terms of capital mobilization has increased from 1.5 percent to about 13.5 percent of GDP. Since its inception, an amount of ₵233.6 billion has been raised through the sale of equities and US\$11 million has been raised through the issue of dollar-denominated corporate bonds. The stock market therefore plays a very important role in Ghana's financial market.

The macroeconomic environment viz. high inflation rates, high interest rates and exchange rate depreciation, the persistent low demand for shares and the absence of foreign investors has contributed to the general low performance of the stock market over the ten-year period. In spite of this, the market has performed extremely well on some occasions. For instance, the listing of Ashanti Goldfields Company Ltd. in 1994 and its subsequent listing on the New York Stock Exchange brought the GSE into the international market. The impact of AGC's listing was drastic. The market capitalization jumped from ₵96.5 billion to ₵1,968.4 billion with AGC having a 57 percent share of the total. As a result, the stock market recorded the highest growth of 124 percent ever achieved in its ten-year period in 1994. The performance of stock markets around the world suffered heavily from the Asian crisis in 1997 giving room for foreign investors to hedge in emerging markets. Ghana's stock market benefited tremendously from the fall outs of the Asian crisis with an influx of foreign investors. As a result, the all share index registered a 65.7 percent growth and was adjudged the best in Africa and the third best in emerging markets in 1998.

The macroeconomic environment in 2000 was characterized by massive depreciation of the cedi, high interest rates and rising inflation rates. All these factors mitigate against investment and more so long-term instruments like stocks and bonds. For instance, the local currency depreciated by over 100 percent whilst inflation at the end of the year was about 41 percent. This impacted heavily on the total market capitalization in dollar terms. Although the Market

Capitalization increased by 14 percent between 1999 and 2000 in cedi terms and ended up at ₵3,655 billion. In dollar terms however, it declined by 56 percent to US\$0.53 billion. The GSE All share Index recorded a 16.5 percent growth compared to a decline of 15.2 in the previous year.

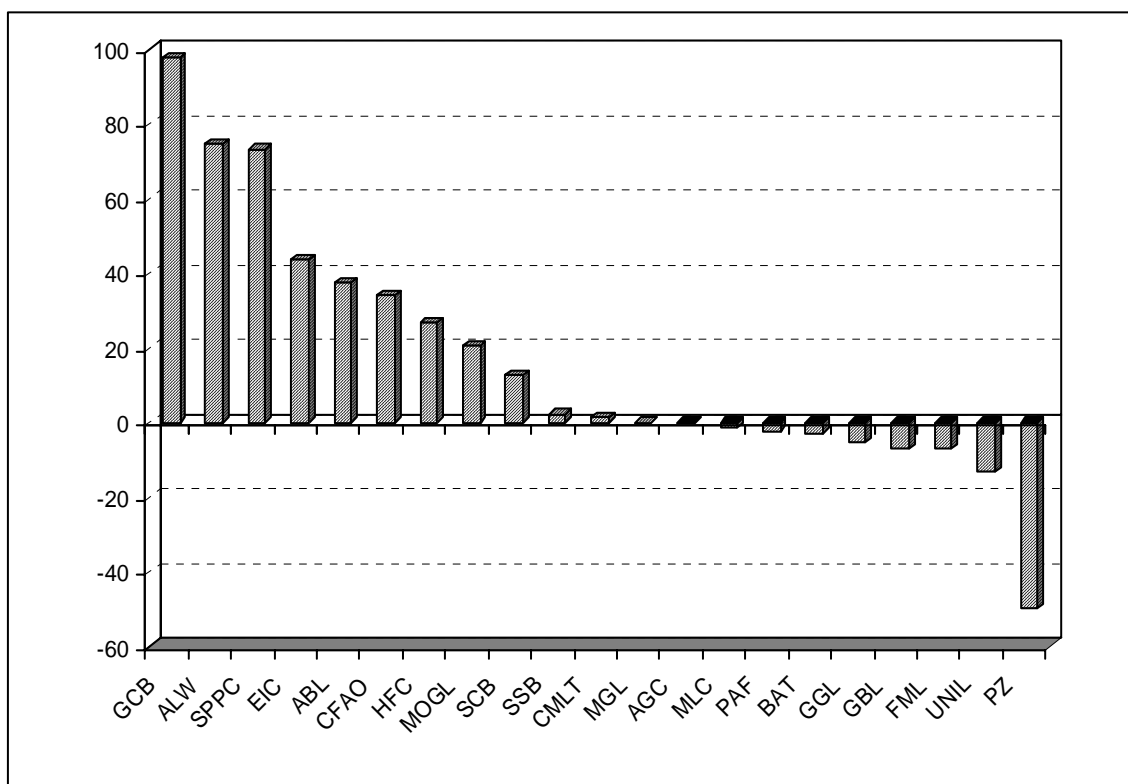
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Volume of Shares Traded (million)	125.6	91.4	49.57	30.72
Value of Shares Traded (₵billion)	93.35	134.01	69.61	50.62
Shares offered per session ('000s)	1512.2	3545.5	2463.6	1602.7
Shares bid per session ('000s)	7737.7	3121.7	634.8	309.3
GSE-All Share Index	524.2	868.35	736.16	857.89
Market Capitalization (₵ billion)	2552.8	3245.6	3206.39	3655.04
Market Capitalization (US\$ billion)	1.25	1.4	1.21	0.53
No. of listed Companies	21	21	22	22
<b>Memo Items:</b>				
<i>Change in GSE Index (%)</i>	<i>45.3</i>	<i>65.7</i>	<i>-15.2</i>	<i>16.5</i>
<i>Change in Mkt. Capitalization (₵) %</i>	<i>-10.8</i>	<i>27.1</i>	<i>-1.2</i>	<i>14.0</i>
<i>Change in Mkt Capitalization (\$) %</i>	<i>-28.8</i>	<i>12.6</i>	<i>-13.6</i>	<i>-56.2</i>
<i>Turnover Ratio</i>	<i>3.7</i>	<i>4.1</i>	<i>2.2</i>	<i>1.4</i>
<i>Offer/Bid Ratio</i>	<i>0.2</i>	<i>1.1</i>	<i>3.9</i>	<i>5.2</i>
<i>91-Day Treasury Bill Discount Rate %</i>	<i>42.5</i>	<i>26.7</i>	<i>31.5</i>	<i>38.0</i>
<i>Inflation Rate (end-year) %</i>	<i>20.8</i>	<i>15.7</i>	<i>13.8</i>	<i>40.5</i>
<i>Exchange Rate Depreciation Rate %</i>	<i>25.2</i>	<i>12.9</i>	<i>14.4</i>	<i>101.0</i>
<i>Source: Ghana Stock Exchange, Accra</i>				

Produce Buying Company was listed in May 2000 bringing the number of companies to 23. However in September 2000, UTC-Estates voluntarily de-listed from the exchange after an extraordinary General Meeting held in April 2000. The number of listed companies then reversed back to 22 by the end of the year.

Turnover volume of stocks traded in 2000 amounted to 30.7 million and valued at ₵50.62 billion. This indicates a decline both in volume and value terms as compared to 49.6 million traded

shares and valued at €69.6 billion for 1999. Trading activity was low in 2000, with offer of shares persistently outweighing bids. The offer/bid ratio was as high as 5.2 compared to 3.9 and 1.1 in 1999 and 1998 respectively. This indicates that for every five shares that were offered, there was only one bid. The low trading activity of most part of the year and high offer volumes led to depressed share prices. Out of the 22 listed companies, three recorded gains above 50 percent, nine recorded capital losses and the rest recorded marginal gains. Ghana Commercial Bank recorded the highest capital gain of 98 percent, followed by Aluworks 74.8 percent and 73.3 percent gain recorded by SPPC (See Fig. 3.2).

**Figure 3.2: Percentage Change in Share Prices as at December 2000**



## 4. REVIEW OF TRADE AND PAYMENTS

### 4.1 Introduction

Ghana's external payments position deteriorated sharply in year 2000 with an overall balance of payments deficit on official settlements of US\$221 million and gross international reserves of less than one month of import cover. Coupled with this is a rising external debt service ratio of 23.4 percent.

### 4.2 The Foreign Exchange Market

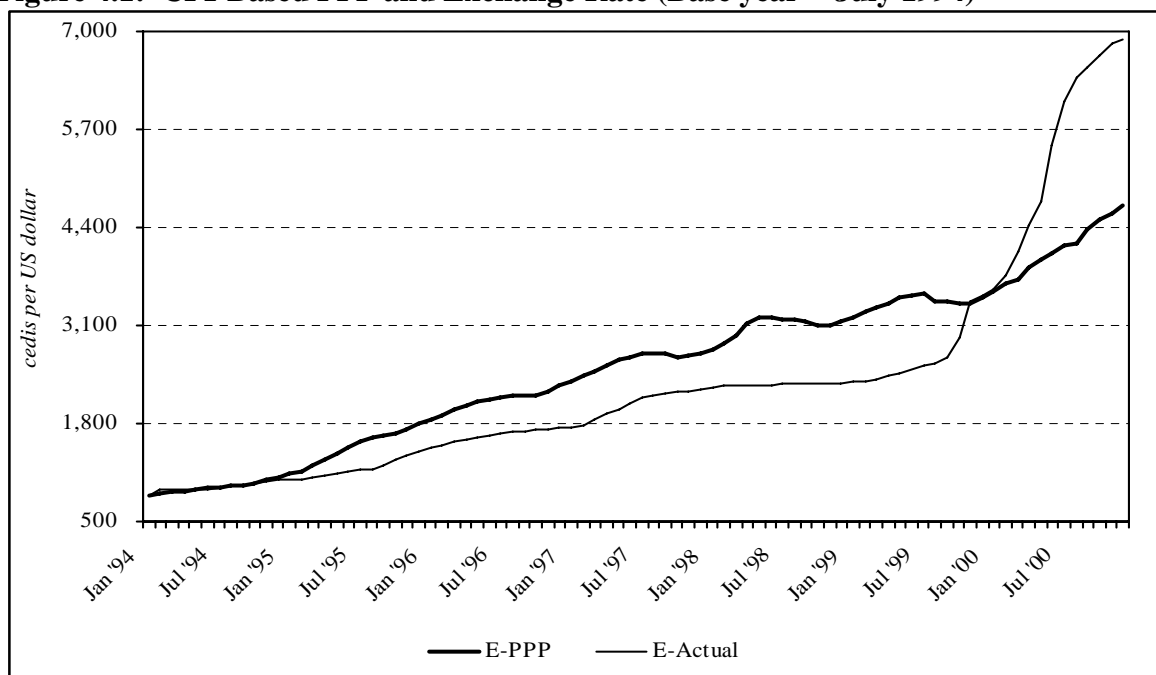
In the foreign exchange market, the deterioration in external payments and the accompanying controls resulted in shifting foreign exchange operations into the parallel market, increasing stocks or pipeline of foreign exchange applications in the deposit money banks (DMBs), and a sharp depreciation of the exchange rate. The nominal exchange rate depreciated by 96.8 percent on a year-on-year basis in 2000, following an equally sharp depreciation of 49.2 percent in 1999.

As shown in Figure 4.1, the relationship between the actual exchange rate and its equilibrium rate as measured by PPP. While PPP in general holds in the long run, in the short-run deviations between the actual (nominal) rate and the PPP rate can give a rough indication of misalignment. From 1995, following the upsurge in inflation to about 70 percent per annum in the aftermath of the abortive Value-Added Tax (VAT), inflation became public enemy number one. As a result, all policies were focused on inflation. However, unable to rein in the fiscal, the monetary authorities looked upon the exchange rate as the nominal anchor against inflationary expectations. As a result, Central Bank intervention in an already segmented market increased through foreign exchange sales and moral suasion.

The fundamental policy issue that was missed was that maintaining a low and predetermined rate of nominal depreciation of the exchange rate required fiscal and monetary restraint. Ghana's experience had shown that maintaining a fixed exchange rate or a predetermined rate of nominal

depreciation in the face of fiscal and monetary expansion resulted in not achieving both our internal and external objectives – low levels of inflation (growth) and external balance. This experience was forgotten.

**Figure 4.1: CPI-Based PPP and Exchange Rate (Base year = July 1994)**



As can be seen from Figure 4.1, the result of this policy stance was that the actual exchange rate deviated increasingly from its PPP rate from about the third quarter of 1995 through the third quarter of 1999. The situation actually worsened in 1998 when as a result of both favorable world market conditions and improved cocoa production, foreign exchange earnings increased while the import bill decreased. Ghana used the additional resources to support the exchange rate in spite of indications and warnings that 1999 may see a reversal of the trend. In 1998, therefore, the nominal exchange rate depreciated by 4 percent on a year-on-year basis.

Policy responses to the crisis were ad hoc and ineffective, in part on account of a wrong diagnosis of the nature of the crisis. For most policy makers in Ghana, the external shock was perceived as transitory and therefore required only financing. Their preferred policy choice was controls and attempts to smoothen out the shock even with depleted reserves. By November

1999, it was clear that the external shock was a permanent one and could therefore not be accommodated by temporary controls and swap arrangements. Yet, this was precisely the response of Ghanaian policy makers. In November, the monetary authorities introduced special swaps targeted at the net foreign assets of the banking system for which a waiver had to be granted by the Fund on account of its multiple currency practice implications.

**Table 4.1: Nominal and Real Exchange Rate Depreciation**

	<i>Nominal Rates of Depreciation (%)</i>				<i>Real Rates of Depreciation (%)</i>	
	<i>Inter-bank Market</i>		<i>Forex Bureau Market</i>		<i>CPI-Based Index</i>	<i>Export Cost Index</i>
	<i>End-Period</i>	<i>Average</i>	<i>End-Period</i>	<i>Average</i>		
<i>Dec '95 - Mar '96</i>	9.39	9.20	5.90	4.60	(1.48)	(13.62)
<i>Dec '95-June '96</i>	14.38	14.85	12.13	10.92	(2.79)	(18.56)
<i>June '96-Dec '96</i>	5.22	5.58	3.65	5.39	(3.29)	(5.50)
<i>Dec '95-Dec '96</i>	20.35	21.26	16.23	16.32	(6.07)	(20.24)
<i>Dec '96 - Mar '97</i>	8.75	7.34	9.31	8.46	(2.37)	(6.38)
<i>Dec '96-June '97</i>	21.57	19.43	26.38	23.43	0.60	(5.72)
<i>June '97-Dec '97</i>	6.37	8.33	3.13	4.86	4.78	5.38
<i>Dec '96-Dec '97</i>	29.31	29.39	29.46	28.81	5.24	(0.62)
<i>Dec '97 - Mar '98</i>	2.48	2.68	2.63	4.05	(6.53)	(3.92)
<i>Dec '97-June '98</i>	3.23	3.18	3.07	4.74	(14.00)	(11.71)
<i>June '98-Dec '98</i>	0.99	1.21	1.27	(0.20)	1.93	(0.56)
<i>Dec '97-Dec '98</i>	4.24	4.41	4.37	3.17	(12.33)	(12.20)
<i>Dec '98 - Mar '99</i>	2.99	2.21	2.92	4.30	(4.56)	(2.58)
<i>Dec '98-June '99</i>	7.83	9.03	7.10	7.58	(4.36)	(3.27)
<i>June '99-Dec '99</i>	38.39	38.30	38.40	36.91	40.39	22.80
<i>Dec '98-Dec '99</i>	49.23	47.98	48.23	47.30	34.27	18.78
<i>Dec '99 - Mar '00</i>	16.97	13.50	16.20	17.86	7.32	(1.06)
<i>Dec '99-June '00</i>	56.70	44.29	59.15	51.66	26.76	13.26
<i>June '00-Dec '00</i>	25.59	37.34	20.35	29.64	18.73	15.55
<i>Dec '99-Dec '00</i>	96.80	98.17	91.55	96.61	50.50	31.36

**Note :** Estimates of the nominal rates of depreciation are based on the cedi/US\$ mid-rates at the interbank and forex markets as reported by the Bank of Ghana.  
Real exchange rates are indexed, such that June 1990=100.0. A negative figure indicates a real appreciation of the exchange rate.

the equilibrium exchange rate was to cause it to depreciate. Consequently, even if by the end of December 1999 the previous misalignment had been fully corrected for, the new market equilibrium rate was once more misaligned vis-à-vis the terms of trade affected equilibrium rate.

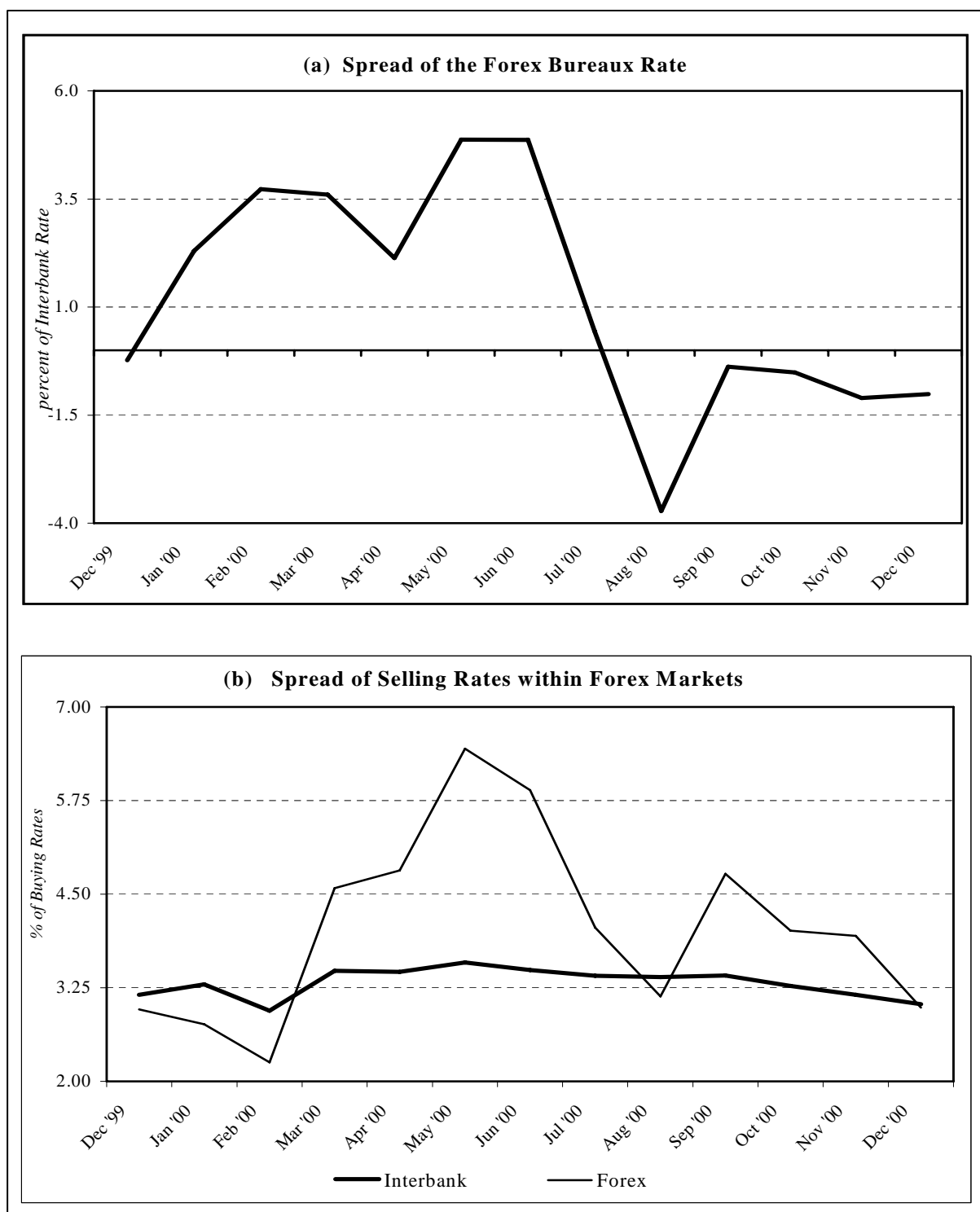
The preferred policy option of the Fund appeared to be either a package including devaluation or resort to the automatic adjustment mechanism. Under sticky prices, the later must first result in overshooting before an eventual equilibrium is attained. Moreover, the cost of relying on such a mechanism in the face of depleted international reserves could be heavy to the nation in terms of growth and employment in the economy.

The very sharp nominal depreciation of the cedi (vis-à-vis the US dollar) in 2000 has been the highest over the past five years (see Table 4.1). While the rate of depreciation of the cedi was most pronounced on the interbank market, it was also swift in the forex bureau – at 91.6 percent – on a year-on-year basis relative to 1999. Moreover, on the basis of officially reported inflation rates, the exchange rate depreciated in real terms in 2000.

Figure 4.2 shows that the exchange rate tended to be more volatile in the forex bureau market than in the interbank market.

In the second half of the year, the rate of depreciation decelerated. However, rates were rising faster in the interbank market than in the forex bureau market. As a result, exchange rates were relatively higher in the interbank than in the forex bureau market in spite of the higher risks associated with the forex bureau market. This is shown by the negative spreads between the mid-rates of the two markets. This situation persisted until the end of the year (see Panel (a) of Figure 4.2) and continued into 2001.

#### **Figure 4.2: Spread Between and Within Forex Markets**



Part of this phenomenon can be explained by the segmentation between the two markets.  
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Segmentation implies that arbitrage between the two markets is limited. Otherwise in a situation where buying rates are falling in the forex bureau market due to lack of demand while there is a pipeline in the DMBs, arbitrage would have easily reduced the difference in rates. In part, this was also due to the Central Bank's concerns about the withdrawal of cash from the DMBs. This implied a limitation on withdrawals of cash from the DMBs for operations in the forex bureau market where cash is the main instrument of transactions.

### 4.3 Balance of Payments

The external payments position of the country in year 2000 was one of the worst in recent times. Against the backdrop of very low levels of international reserves, huge trade and current accounts deficits and declining long and medium term official and private capital net inflows, the overall balance of payments situation worsened for the second consecutive year.

On an official settlements basis, Ghana's overall balance of payments position deteriorated sharply in 2000 compared to the three years preceding it. The overall balance of payments deficit (official settlements basis) worsened from US\$156 million – the equivalent of 1.2 percent of GDP – at the end of 1999 to US\$221 million or 3.6 percent of GDP at the end of 2000. These deficits contrast with overall balance of payments surpluses amounting to 0.4 percent of GDP and 1.3 percent of GDP in 1997 and 1998 respectively.

On the demand side, the worsening of the external balance position was due to two policy adjustment failures. Adjustment to an external shock would usually involve both fiscal and monetary restraint in order to narrow the savings-investment gap and reduce demand pressures on the external account. However, instead of the required fiscal restraint, both in 1999 and 2000, government expenditures increased substantially especially in the last quarter of 2000. This was accommodated by monetary expansion especially through borrowing from the Central Bank.

	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>Merchandise Exports (fob)</b>	1,809.3	2,090.8	2,006.4	1,898.4

Gold	579.2	687.8	710.8	705.0
Cocoa Beans and Products	470.0	620.4	552.3	436.8
Timber & Wood Products	172.0	171.0	174.0	175.2
Others (n.e.c.)	588.1	611.6	569.3	581.4
<i>of which</i> Non-Traditional Exports	166.5	242.8	262.3	231.9
<b>Imports (fob)</b>	3,040.9	2,896.5	3,252.3	2,758.6
Oil Imports	233.9	215.0	333.3	520.1
Non-Oil Imports	2,807.0	2,681.5	2,919.0	2,238.5
<b>Trade Balance</b>	(1,231.6)	(805.7)	(1,245.9)	(860.2)
Services (net)	(310.7)	(308.2)	(268.7)	(246.0)
<i>of which</i> Interest Payments	(145.4)	(148.8)	(131.2)	(109.0)
Private Transfers (net)	400.3	453.8	470.4	495.5
<b>Current Account Balance (CAB)</b>	(1,142.0)	(660.1)	(1,044.2)	(610.7)
Official Transfers (net)	159.7	280.1	148.4	154.1
<i>of which</i> Project Grants	96.0	212.0	92.5	112.0
Program Grants	31.0	42.0	55.9	42.1
Other	32.7	26.1	-	-
<b>CAB (including official transfers)</b>	(982.3)	(380.0)	(895.8)	(456.6)
<b>Capital Account Balance</b>	492.8	449.8	500.8	157.0
Official Long/Medium (net)	499.4	348.9	126.5	97.0
Long-Term Loans (net)	415.7	443.7	176.5	173.0
Medium-Term Loans (net)	83.7	(94.8)	(50.0)	(76.0)
Private Long/Medium (net)	55.4	(10.4)	115.4	65.0
Short-Term Capital (net)	(62.0)	111.3	258.9	(5.0)
Non-Monetary	(94.9)	23.3	58.5	(32.0)
Monetary Short-Term	32.9	88.0	200.4	27.0
Errors and Omissions	514.4	29.5	239.6	77.9
<b>Overall Balance</b>	24.9	99.3	(155.4)	(221.7)
<i>of which</i> Change in Arrears	-	-	62.0	27.0
Official Settlements 1/	24.9	99.3	(93.4)	(194.7)
<b>Memorandum Items</b>				
Average Exchange Rate (¢/US\$)	2,050.3	2,314.2	2,647.3	5,321.6
Gross International Reserves				
End of Period (US\$ millions)	508.5	507.7	419.0	224.0
Equivalent months of Imports (cif)	1.9	1.9	1.4	0.9
Non-Oil Imports (cif) - (US\$ millions)	3,041.1	2,905.1	5,946.2	2,425.2
Gross Domestic Product (US\$ million)	6,890.8	7,470.1	7,773.9	5,416.2
<b>Percent of Gross Domestic Product</b>				
Current Account Deficit (incl. Off. Transfers)	(14.3)	(5.1)	(11.5)	(8.4)
Current Account Deficit (excl. Off. Transfers)	(16.6)	(8.8)	(13.4)	(11.3)
Trade Balance	(17.9)	(10.8)	(16.0)	(15.9)
Merchandise Exports (f.o.b.)	26.3	28.0	25.8	35.1
Merchandise Imports (f.o.b.)	44.1	38.8	41.8	50.9
Overall Balance (official settlements basis) 1/	0.4	1.3	(1.2)	(3.6)
<i>Source : Bank of Ghana, Accra</i>				
1/. Refers to changes in the Net Foreign Assets (NFA) of the Bank of Ghana.				

Secondly, policy makers failed to pass through the effects of the huge nominal depreciation in the exchange rate to prices in all sectors of the economy. Not only did this encourage much

higher consumption than would have been the case, but it also adversely affected government revenues.

As a result of the inability to adjust, the huge depreciation resulted in a decrease in imports of only 15.2 percent in 2000 from a high of US\$3,252.3 million in 1999. While expenditure on non-oil imports fell by 23.3 percent in 2000, the country's import bill on crude oil and refined petroleum products rose dramatically by 56 percent both on account of rising World Market prices (67 percent) and an increase in volume. We are unable to estimate the increase in the volume of crude oil imports because there was a considerable shift to refined petroleum products imports. Imports of refined petroleum products in 2000 appear to have exceeded crude oil imports.

On the supply side, the external payments difficulties were due to a decrease in export earnings and failed expectations with respect to external capital inflows. The value of Ghana's merchandise exports dropped by 5.4 percent in 2000 relative to 1999. This was on account of both lower prices in the world market for her traditional exports (cocoa, gold and timber) as well as decreases in the volume of exports.

The value of cocoa beans and products exports dropped by 21 percent as a result of a 23 percent fall in the price of cocoa beans exported from Ghana. In the case of gold, even though there was a wide variation in prices realized amongst the gold mining companies, the average price realized by Ghana was higher than the price realized in 1999. Thus the value of gold exports fell slightly because of a decrease in the volume of gold exported.

Export earnings from the shipment of timber and wood products also stagnated in year 2000, increasing by less than 1 percent. This was in spite of an increase in earnings from the export of wood products, even as export volumes and the world market price for timber (mainly lumber) declined by more than 11 percent. The contribution of non-traditional exports, meanwhile, proved inadequate to salvage the situation.

Overall, the relatively lower import bill and the rather sluggish performance of exports in 2000 resulted in the reduction, in nominal dollar terms, of the country's huge trade deficit of

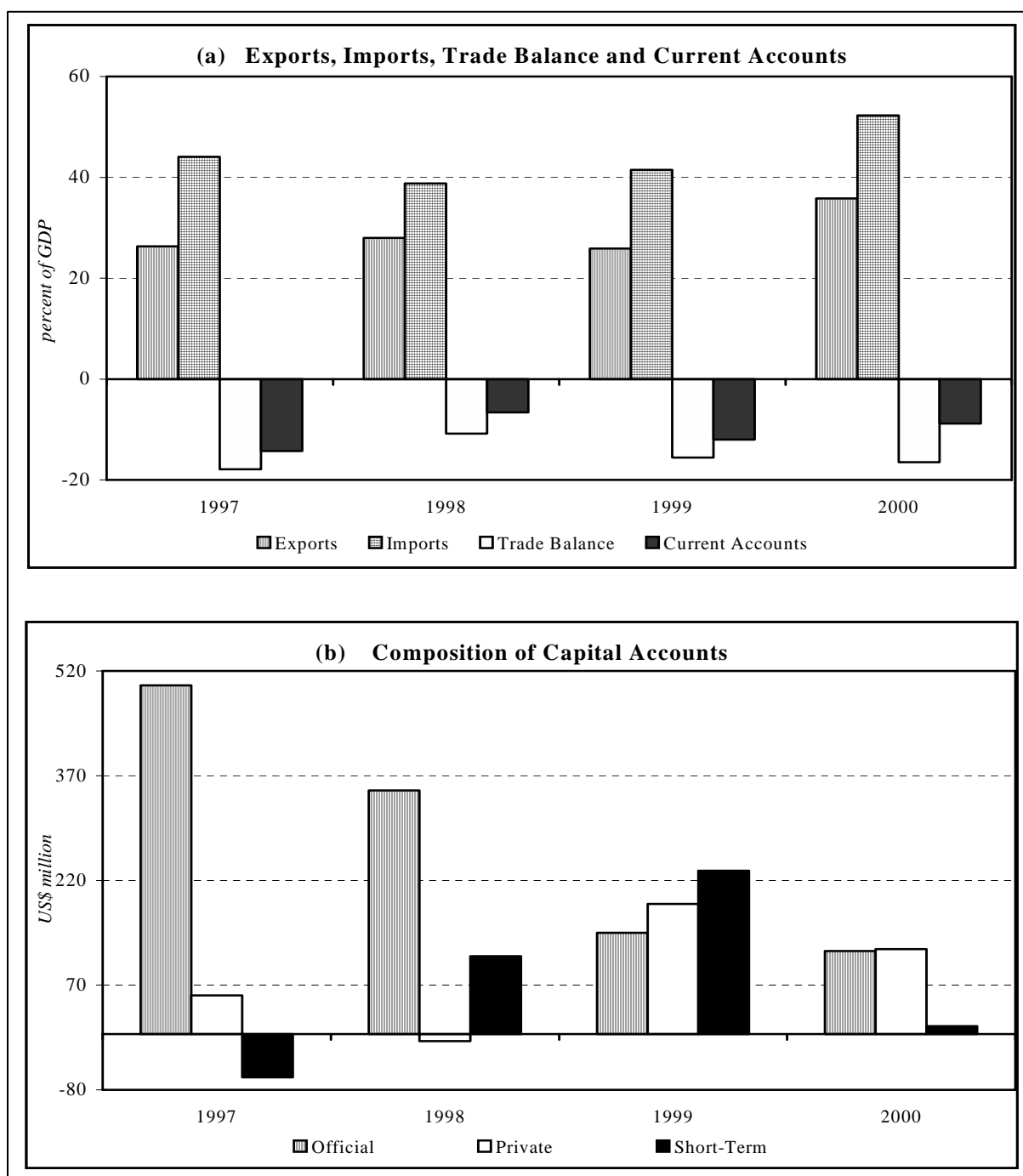
US\$1,245.9 million in 1999 to US\$860.2 million in 2000. Combined with an improvement in the services accounts, the improved trade deficit led, in turn, to a marked reduction in the deficits on the current account of the balance of payments. The current account deficit (excluding official transfers) dropped from 13.4 percent of GDP at the end of 1999 to 11.3 percent of GDP at the end of 2000.

Coinciding with these developments, however, was also a 3.5 percent increase in the levels of net official transfers, from US\$148.4 million in 1999 to US\$154.1 million in 2000. While project grants increased by 21 percent in 2000 relative to the levels in 1999, program grants declined by 25 percent. In any case, the US\$154.1 million registered in 2000 was lower than the average for the period 1997-99. It also represented frustrated expectations, as Ghana was expecting much higher levels of inflows (US\$204 million in the 2000 Program).

On Official Capital Inflows (US\$97 million), the situation was worse, as expectations (US\$258 million) were much higher. Given these expectations, therefore, the fiscal became expansionary in anticipation of capital inflows that did not materialize.

Ironically, at a time when it was most needed, Private Capital Inflows, consisting largely of foreign direct investment and divestiture receipts, decreased by nearly 44 percent in 2000 relative to the levels registered in 1999. There was also a net outflow of mainly short-term non-monetary capital, reflecting especially repayment of short-term loans in respect of suppliers' credits. In the face of payment difficulties, short-term non-monetary loan facilities dried up. These developments, no doubt, were in response to the weakening macroeconomic fundamentals of the economy.

### **Figure 4.3: External Trade Indicators**



#### 4.4 Overall Trends in Exports

Unfavorable world market conditions affecting commodity-exporting economies, mainly a continued decline in cocoa, gold and other primary commodity prices, adversely affected

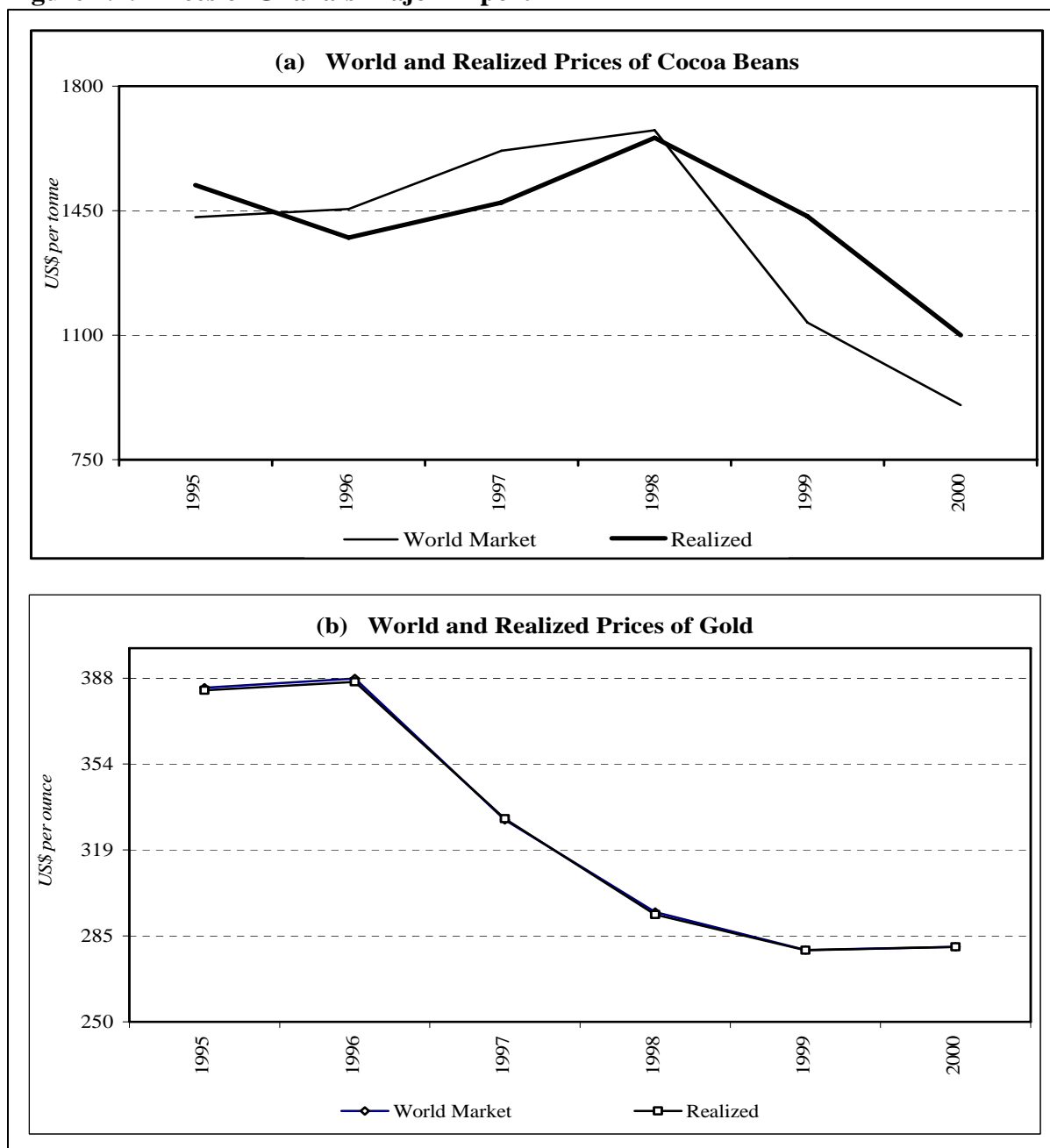
Ghana's export earnings in both 1999 and 2000. Total earnings from both traditional and non-traditional exports in year 2000 amounted to US\$1898.4 million compared to US\$2006.4 million for the year 1999. This represented a 5.4 percent decline in overall export earnings.

Export earnings from the shipment of cocoa beans dropped by almost 25 percent from US\$497.3 million at the end of 1999 to US\$374.0 million in 2000. Accounting for the poor earnings performance was the continued downward slide in the price on major cocoa exchanges worldwide by about 22 percent as well as a 2 percent fall in export volumes in 2000.

	<i>Value, Volume and Unit Prices</i>				<i>Growth Rates</i>		<i>Share in Total Receipts</i>	
	1997	1998	1999	2000	1999	2000	1999	2000
<b>Cocoa Beans and Products</b>	<b>470.0</b>	<b>620.4</b>	<b>552.3</b>	<b>436.8</b>	-11.0%	-20.9%	27.5%	23.0%
<b>Cocoa Beans (US\$ million)</b>	<b>384.8</b>	<b>541.6</b>	<b>497.3</b>	<b>374.0</b>	-8.2%	-24.8%	24.8%	19.7%
Volume (000' metric tonnes)	261	327	347	340	5.9%	-2.0%		
Implicit Unit Price (US\$/tonne)	1,473	1,655	1,434	1,100	-13.4%	-23.3%		
<b>Cocoa Products (US\$ million)</b>	<b>85.2</b>	<b>78.8</b>	<b>55.0</b>	<b>62.8</b>	-30.3%	14.2%	2.7%	3.3%
<b>Gold (US\$ million)</b>	<b>579.2</b>	<b>687.8</b>	<b>710.8</b>	<b>705.0</b>	3.3%	-0.8%	35.4%	37.1%
Volume (000' fine ounces)	1,747	2,347	2,551	2,473	8.7%	-3.0%		
Implicit Unit Price (US\$/ounce)	331.5	293.1	278.9	285.0	-4.8%	2.2%		
<b>Timber &amp; Wood Products (US\$ m)</b>	<b>172.0</b>	<b>171.0</b>	<b>174.0</b>	<b>175.3</b>	1.7%	0.8%	8.7%	9.2%
<b>Lumber (US\$ million)</b>	<b>101.0</b>	<b>86.4</b>	<b>88.4</b>	<b>67.0</b>	2.3%	-24.2%	4.4%	3.5%
Volume (000' cubic meters)	298.1	252.7	237.2	209.6	-6.1%	-11.7%		
Implicit Unit Price (US\$/cu. m)	338.9	342.0	372.8	319.9	9.0%	-14.2%		
<b>Wood Products (US\$ million)</b>	<b>71.0</b>	<b>84.6</b>	<b>85.6</b>	<b>108.3</b>	1.1%	26.6%	4.3%	5.7%
Volume (000' metric tonnes)	96.5	163.0	183.2	185.6	12.4%	1.3%		
Implicit Unit Price (US\$/tonne)	735.4	519.0	467.0	591.1	-10.0%	26.6%		
<b>All Others (US\$ million)</b>	<b>588.1</b>	<b>611.6</b>	<b>569.3</b>	<b>581.4</b>	-6.9%	2.1%	28.4%	30.6%
<i>of which</i> Diamonds	11.4	10.6	9.0	11.8	-15.8%	32.1%	0.4%	0.6%
Bauxite	10.8	7.4	7.6	6.6	3.4%	-13.1%	0.4%	0.3%
Manganese	11.6	12.1	21.7	17.1	80.1%	-21.2%	1.1%	0.9%
Non-Traditional Exports	166.5	242.8	262.3	231.9	8.0%	-11.6%	13.1%	12.2%
<b>TOTAL EXPORTS (US\$ million)</b>	<b>1,809.3</b>	<b>2,090.8</b>	<b>2,006.4</b>	<b>1,898.5</b>	-4.0%	-5.4%	100.0%	100.0%

Source: Bank of Ghana Research Department, Accra

**Figure 4.4: Prices of Ghana's Major Export**



It is to be recalled that beginning in 1999 cocoa prices on major world markets had languished at historical lows, having fallen from US\$1590 per metric tonne at the end of 1998 to US\$954 per metric tonne at the end of 1999. This downward slide continued into 2000, reaching US\$881 per metric tonne at the end of the year. These developments notwithstanding, the average price realized by Ghana was higher in 2000 than in 1999, and also higher than the world market price as a result of the marketing strategy of the COCOBOD. Combined with the slight drop in export

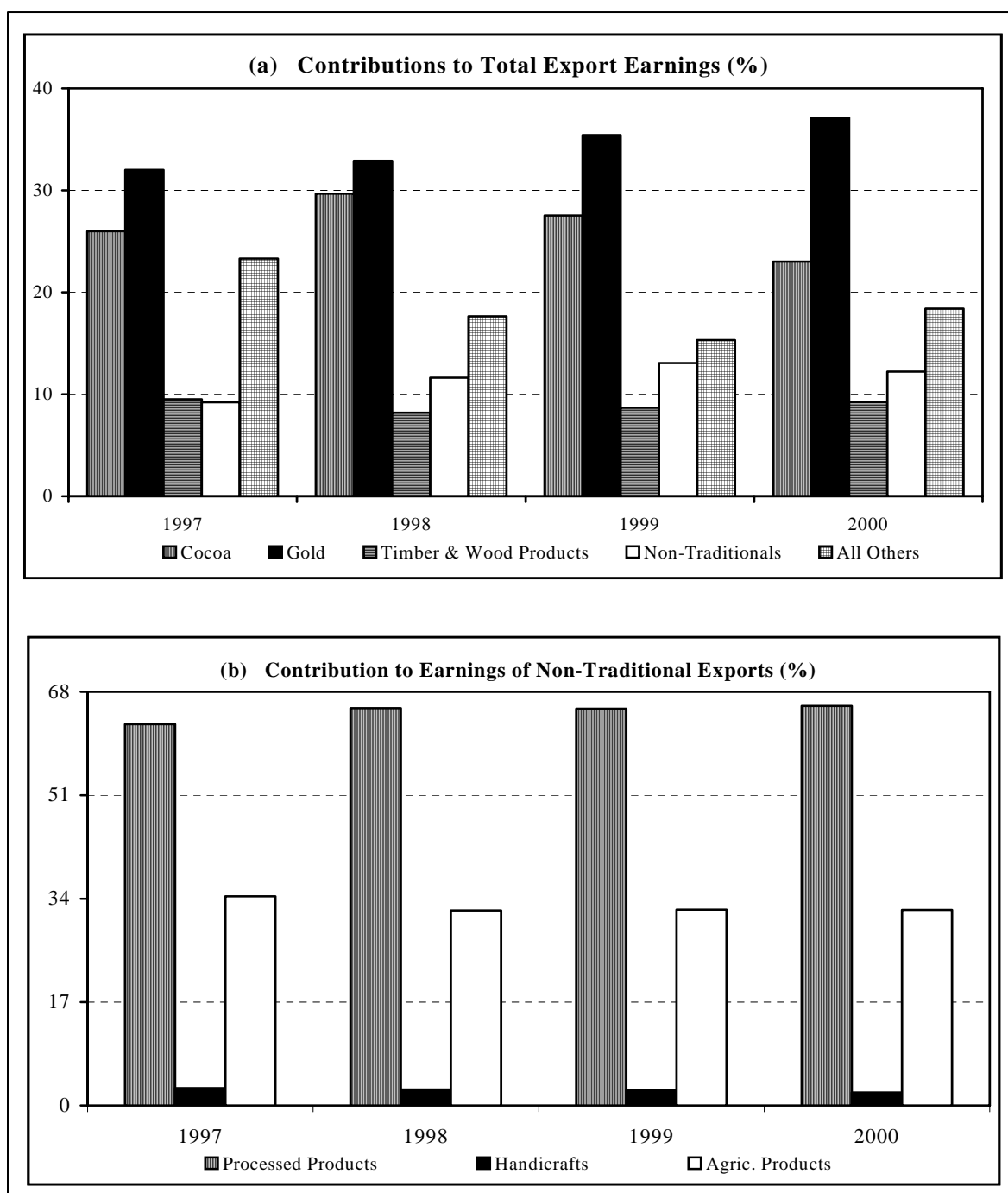
volumes, however, this resulted in lowering the share of cocoa export receipts in the total exports to 22.5 percent – lower than that of gold (36.2 percent) but higher than that of timber exports (9 percent).

In spite of the fact that gold export receipts dropped from US\$710.8 million at the end of 1999 to US\$702 million, the metal continued to be the country's dominant export-earning commodity in 2000. Even though the average realized price of Ghana's gold exports increased marginally by 0.4 percent, gold export earnings declined by 1.2 percent on account of a 3 percent decrease in export volumes in 2000 (see Table 4.3 and also Figure 4.4).

Export earnings from the shipment of timber and wood products remained virtually stagnant at US\$175 million in 2000. This was slightly above levels registered in the preceding three years, marginally pushing its share in total export earnings up by 0.4 percentage points from 8.6 percent per annum in 1999 to 9 percent at the end of 2000.

As shown in Table 4.3, export volumes and earnings from the shipment of timber (mainly lumber) have declined intermittently since 1997. In year 2000 a decline in earnings of 24.2 percent was recorded against the background of a rise in the world market price of hardwood logs and decreasing export volumes. Thus while world market prices increased on average from US\$187 per cubic meter at the end of 1999 to US\$190 per cubic meter in 2000, earnings from the export of Ghana's timber logs declined from US\$88.4 million in 1999 to US\$67 million at the end of 2000 on account of a fall in export volumes.

#### **Figure 4.5: Export Shares in Total Earnings**



The declining export volumes of hardwood logs and lumber is partly on account of the imposition by the Ghanaian Authorities of a fixed quota on the exports of timber logs in early 1995. This decision was taken in a bid to control the fast rate of deforestation that was occurring at the time. A twin purpose of that decision was also to encourage and promote the processing of

timber products in order to add value to exports. The available evidence is that the country's exports of wood products (mainly veneer, plywood, and furniture parts) appear to have cushioned the decline in earnings from timber (lumber and hardwood). Earnings have been rising on account of a marginal increase in export volumes and rising world market prices.

The performance of non-traditional exports in 2000 was sluggish and disappointing. Marketing strategies may still be poor and possibly lacking the dynamism required in competitive markets. Major exporters in the sector continue to complain about high utility tariff rates and high costs of domestic bank credits. There are also concerns raised in connection with the financing and promotion of non-traditional exports in Ghana – the Ghana Export Promotion Council that was set up almost three decades ago to be responsible for this receives limited financing from government.

Earnings from non-traditional exports (defined to exclude processed cocoa and wood products), declined by 11.6 percent from US\$262.3 million in 1999 to US\$231.9 million at the end of 2000. This decline also pushed its share in total export earnings downwards from 13.1 percent to 12.2 percent (see Figure 4.5).

Despite the drop in its share of total earnings, the commodity composition of non-traditional exports has changed very little over the years. The share of export earnings from processed products (mainly processed and semi-processed foods, processed natural rubber and non-ferrous metal scrap), for example, has remained the same at 65 percent as in the preceding two years. This has also been the case with respect to agricultural products, comprising horticultural products, fish and seafoods and medicinal plants and kola nuts (see Panel (b) of Figure 4.5).

The contribution of all other Exports – largely diamonds, bauxite, manganese, residual oils and electricity – was a little more than in 1999. This contrasts with the decline in share in respect of cocoa beans and products. The share of the earnings of this group of export commodities in the total rose from 28.4 percent in 1999 to 30.6 percent in 2000.

#### 4.5 Overall Trends in Imports

The country's overall expenditures on (oil and non-oil) imports in 2000 declined by 15.2 percent from US\$3252.3 million at the end of 1999 to US\$2758.7 million at the end of 2000. This decline is in sharp contrast to the 12.3 percent increase in the overall imports bill registered in 1999 relative to 1998. It is also larger than the decline of 4.1 percent reported in 1998 relative to 1997 (see Table 4.4).

	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>Average 1997-1999</b>	<b>Average 1997-2000</b>
<b>Imports f.o.b. (US\$ millions)</b>	<b>3,040.9</b>	<b>2,896.5</b>	<b>3,252.3</b>	<b>2,758.7</b>	3,063.2	2,987.1
Non-Oil Imports	2,807.0	2,681.5	2,919.0	2,238.6	2,802.5	2,661.5
Oil Imports	233.9	215.0	333.3	520.1	260.7	325.6
<b>Actual Growth Rates (%)</b>						
Imports f.o.b.	57.0%	-4.7%	12.3%	-15.2%	21.5%	12.3%
Non-Oil Imports	67.3%	-4.5%	8.9%	-23.3%	23.9%	12.1%
Oil Imports	-9.7%	-8.1%	55.0%	56.0%	12.4%	23.3%
<b>Percentage Shares in Total Import Bill</b>						
Non-Oil Imports	92.3%	92.6%	89.8%	81.1%	91.5%	88.9%
Oil Imports	7.7%	7.4%	10.2%	18.9%	8.5%	11.1%
<b>Memorandum Items</b>						
<b>GDP (US\$ millions)</b>	<b>6,890.8</b>	<b>7,470.1</b>	<b>7,773.9</b>	<b>5,416.2</b>	<b>7,378.3</b>	<b>6,887.8</b>
Imports/GDP Ratio (%)	44.1%	38.8%	41.8%	50.9%	41.6%	43.9%
Non-Oil Imports	40.7%	35.9%	37.5%	41.3%	38.1%	38.9%
Oil Imports	3.4%	2.9%	4.3%	9.6%	3.5%	5.0%
<b>Brent Crude Oil Price (US\$/barrel)</b>						
Monthly Average	18.55	12.72	17.81	27.43	16.36	19.13
End-December	17.10	9.80	25.59	25.28	17.50	19.44
<i>Sources: Bank of Ghana (Research Department) and CEPA Staff Estimates.</i>						

Expenditure on crude oil imports increased by more than 50 percent in 2000 relative to 1999. Continuing price hikes on international markets has been responsible for this development. The price of crude oil almost doubled to US\$30.0 per barrel by the end of June 2000 compared to US\$15.77 per barrel registered in June of the previous year, even as there were moves by the producers' cartel, the Organization of Petroleum Exporting Countries (OPEC), to reverse an earlier decision in 1999 to cut production levels in a bid to raise prices. Following an emergency meeting by key members of the cartel in October 2000, output levels were raised by some 500,000 barrels a day in ten member countries. This had the effect of depressing prices somewhat, stabilizing at US\$25.0 per barrel – price levels also reached in 1999 – at the close of

2000. This, coincidentally, is where the industry consensus in 1998 had wanted prices to be in the first place.

While there are indications that the volume of crude oil and refined petroleum products imports into Ghana might have increased in 2000, it is somewhat difficult to estimate the exact volume.

Official statistics reveals that the country's non-oil imports bill dropped sharply by nearly 23 percent in year 2000 relative to 1999. This deceleration in growth compares with 8.9 percent acceleration in growth experienced in 1999, and is also greater than the 4.5 percent deceleration in growth that was registered in 1998. In nominal terms, expenditure on non-oil imports in 2000 fell from a peak of US\$2919.0 million in 1999 to US\$2238.6 million. The decline also meant that the share of this category of imports in the country's overall import bill fell by some 8.7 percentage points (from 89.8 percent in 1999) to 81.1 percent in 2000.

#### **4.6 External Debt and Debt Service Payments**

Confusing signals continued to pervade the external debt service payments position of the country in year 2000. In an earlier edition of its *Macroeconomic Review and Outlook*, CEPA had noted serious problems at reconciling data on the country's external debt stock as published by the Bank of Ghana on the one hand, and that published by the International Monetary Fund on the other. These problems seemed to have persisted into 2000, with potentially damaging consequences.

In an Aide-Memoir dated November 21 2000, the Fund expressed dismay and lack of credibility in the Ghanaian Monetary Authorities for providing what it referred to as 'incorrect' data on the country's external debt payments. It noted among other things that:

*“The Mission was unable to obtain basic historical data to verify whether 2000 debt payments were current. All indications suggest that external arrears have persisted through November 2000.”*

It went on:

*“The Mission found that the information provided to the Fund before the August 2000 Executive Board Meeting was incomplete. First, the staff was led to believe that the proceeds from the sale of Ghana Telecom shares that were to be received in July were high enough to assure program financing. Secondly, the staff was told that Ghana was current on its payment of external debt service at the time of the Board meeting. Both these statements proved to be incorrect.”*

These observations are quite serious, coming in a context in which Ghana has a three-year Poverty Reduction and Growth Facility (PRGF) Arrangement with the Fund expected to remain operational up to May 2, 2002. They also raise serious questions about what the true external debt stock position of the country is. Any useful debt sustainability analysis will require that the true position is known.

It is now estimated that Ghana had accumulated US\$68.0 million arrears in 1999 and a further US\$21.0 million in 2000, bringing the total outstanding external arrears at the beginning of 2001 to US\$89.0 million. It would appear that the larger accumulation of 1999 was with the knowledge of the Fund. It can be readily recalled that in the fourth quarter of 1999 the cedi depreciated sharply as the terms of trade shock impacted and reserves fell sharply.

Official statistics on Ghana’s external debt stock – reportedly revised in the course of a debt sustainability analysis (DSA) by the Fund – increased by 2 percent from US\$5833 million at the end of 1999 to US\$5947 million at the end of 2000.

The increase in Ghana’s external debt stock in 2000 was largely on account of increased net borrowing from bilateral sources. While multilateral lending on a net basis remained unchanged, borrowing from bilateral sources increased by 4.8 percent from US\$1840 million in 1999 to US\$1929 in 2000, marginally raising its share to 32.4 percent of the total debt stock (see Table 4.5).

<b>Table 4.5: External Public Debt and Debt Service Payments (US\$ million)</b>		
	<b>1999</b>	<b>2000</b>
<b>Total External Public Debt</b>	<b>5,832</b>	<b>5,947</b>
Multilateral (including IMF)	3,992	3,993
Bilateral 1/	1,840	1,929
Other (Short-term) 2/	-	25
<b>External Public Debt Service</b>		
<b>Principal</b>	<b>401</b>	<b>453</b>
Medium Term	261	301
Long Term	64	115
IMF Repurchases	76	37
<b>Interest</b>	<b>121</b>	<b>108</b>
Medium Term	48	49
Long Term	70	55
IMF Charges	3	4
<b>Total Debt Service</b>		
Including IMF	522	561
Excluding IMF	443	520
<b>Memorandum Items</b>		
<i>External Debt Service Ratio 3/</i>		
<i>Including IMF</i>	21.0%	23.4%
<i>Excluding IMF</i>	17.8%	21.7%
<i>External Public Debt Service/GDP Ratio (%)</i>		
<i>Including IMF</i>	6.7%	10.4%
<i>Excluding IMF</i>	5.7%	9.6%
<i>External Public Debt/GDP Ratio (%)</i>	75.0%	109.8%
<i>External Public Debt/Govt. Revenue (%)</i>	524.6%	661.4%
<i>Percentage Shares in Total</i>		
<i>Multilateral</i>	68.4%	67.1%
<i>Bilateral Debt Stock</i>	31.6%	32.4%
<i>Short-Term Debt Stock</i>	0.0%	0.4%
<i>Exports of Goods and Services (US\$ million)</i>	2,485.7	2,397.4
<i>Government Domestic Revenue (US\$ million)</i>	1,111.7	899.1
<i>Gross Domestic Product (US\$ millions)</i>	7,773.9	5,416.2
<i>Average Exchange Rate (¢/US\$)</i>	2,647.3	5,321.6
<i>Source: International Monetary Fund (African Department)</i>		
Notes: 1/ Includes medium term loans		
2/. The Short-term debt of the BOG excludes trade credits for TOR and Cocobod		
3/. Ratio of public debt service to exports of goods and services		
4/. Data on the debt stock for 2000 was revised on the basis of the DSA by the Fund		

Developments in 2000 also indicate that external debt servicing continued to absorb a sizable proportion of Ghana's export revenues, consequently raising the debt service ratio – the ratio of the external debt service to exports of goods and services – from 21 percent to 23.4 percent. As a proportion of GDP, the total publicly guaranteed external debt stock rose from 75 percent in 1999

to 109.8 percent in 2000. The developments that changed the picture in respect of Ghana's eligibility to the HIPC Initiative was the sharp rise of the external debt/government revenue ratio to 661.4 percent which opened the fiscal window to Ghana. The sharp depreciation of the cedi shrank the dollar value of government revenues.

## **5. REVIEW OF THE SOCIAL SECTOR: BASIC AND SECONDARY EDUCATION**

### **5.1 Introduction**

Economic progress or development is measured not only using per capita growth rates but also by what happens to indicators such as the adult literacy rate, infant and child mortality rates, the proportion of children who are stunted or wasted etc. These are indicators that capture aspects of the individual's well being. Improvements in these indicators are important guidelines of the goal to reduce poverty. It is recognized that improving upon the education and health of individuals not only has an intrinsic value for the individual, but in the appropriate setting can increase their income-generating capacities and consequently their choice sets.

Several studies on the determinants of poverty in Ghana have found that the education of the household head and of the members of the household is a significant determinant of poverty. Education is a means of lifting an individual and household out of poverty. The benefits of education and good health are not limited to the individual. Society also benefits from an educated and healthy populace. Social sector policies therefore form an important and integral part of any country's development strategy.

In recent months developments in the education and health sectors have formed the topic of most public debates. In the education sector there is concern about the quality of education and the glaring and unacceptable differences between rural and urban schools. Education funding is still a very sensitive issue at the tertiary education level. This review of the social sector focuses primarily on basic and secondary education<sup>12</sup>.

### **5.2 Education Reforms**

The reforms began in 1987 with the intake of the first set of Junior Secondary School entrants. The senior secondary school system began in 1990 and the first Senior Secondary School Certificate Examination (SSCE) was taken in 1993. The middle school system was phased out in

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*12 Subsequent CEPA reviews will examine the tertiary education and health sectors.*

1989 when the last set of students took the Middle School Leaving Certificate. The ‘O’ and ‘A’ level systems were phased out in 1994 and 1996 respectively.

The education reforms begun in 1987 had the following objectives:

- *To expand and make access more equitable at all levels of education.* There were significant differences in educational attainment measured by years of education on the basis of gender and location. Access to senior secondary school (SSS) was to be increased by ensuring that 50% of the JSS leavers entered SSS<sup>13</sup>. Twenty-five percent of SSS graduates were to be absorbed by the tertiary institutions.
- *To change the structure of the school system.* The reforms aimed at reducing the number of years of pre-tertiary education. It was expected that this would reduce cost to both individuals and the state.
- *To improve pedagogic efficiency and effectiveness.* The education system tended to emphasize rote recall. It was necessary to inculcate a better understanding of the subject matter and improve upon practical and analytical skills.
- *To make education more relevant.* There was the concern that the curriculum was not relevant to the needs of the Ghanaian economy. It was considered that there was a need to have more “practical” subjects, for example agriculture.
- *To ensure financial sustainability of the sector through the containment of costs and sharing of such costs with users.* It had become increasingly difficult for central government to provide the necessary funding for education.
- *To enhance sector management and budgeting procedures.* The Education Ministry was constrained by limited planning capacity. Budget uncertainties made planning difficult and monitoring was inadequate.

**Free Compulsory Universal Basic Education.** Currently reforms in the basic education sector are being implemented under the umbrella of the Basic Education Sector Improvement Programme (popularly known as fCUBE). The basic education programme aims at providing all

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*13 In the education system that was being replaced only a fraction of those who sat for the common entrance examination gained admission to secondary schools. It is estimated that between 1965 and 1968 approximately 17% of the candidates for the examination gained admission to secondary school. The proportion increased to an average of 22% between 1971 and 1974. There were many who were qualified to enter but could not because of lack of space (Addae-Mensah et al, (1973).*

children with the ability to pursue further education or acquire skills for the world of work. Under this programme the Government of Ghana is committed to providing free, quality education at the basic level to all children of school going age by the year 2005. The components of education expenses that are to be provided free under this scheme are tuition, textbooks, equipment and tools<sup>14</sup>. Tuition is to be provided free to all in the public basic education system. Textbooks are to be provided free at the primary level to both public and private schools. At the JSS level pupils are expected to pay a textbook user fee that should not be more than 10% of the average total cost of the textbook supplied per pupil. Equipment is to be provided free to all basic education schools in the public school system.

It is within the context of this policy framework that an assessment will be made of enrolment, the quality of education and financing of basic and secondary education for the year academic year 1999/2000.

### **5.3 Trends in Enrolment and Examination Performance**

It is difficult to comment on trends in enrolments, number of schools and teachers in the private schools. This is because coverage of these schools by the Ministry of Education is not complete nor is it consistent. Data is obtained on the basis of questionnaires that are sent to the schools. Thus numbers may vary over time because of variation in the response rate and on the extent to which the Ministry is able to capture all the schools in its census. Due to the problems associated with interpreting the data from the private schools, this review will concentrate only on the public school system.

#### **5.3.1 Primary Education**

##### ***Enrolments***

It is estimated that enrolment in the public primary schools increased by 2.6% from 2,061,743 in 1998/99 to 2,114,037 in 1999/2000. Unfortunately it is not possible to estimate gross enrolment ratios because the population census data is not available to do this. However preliminary estimates of the national population growth rate put it at 2.5%. If we make the assumption that

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*14 Details of the programme are to be found in the Policy Document of the Basic Education Sector Improvement Programme published by the Ministry of Education, April 1996.*

the population aged between 6-11 grew at approximately this rate between 1999 and 2000, this implies that the gross enrolment primary rate remained fairly constant between the two years.

<i>Regions</i>	<b>1988/99</b>			<b>1999/2000</b>			<b>Percent</b>
	<b>Boys</b>	<b>Girls</b>	<b>Total</b>	<b>Boys</b>	<b>Girls</b>	<b>Total</b>	<b>Change</b>
Ashanti	185344	167409	352753	188557	172204	360761	2.27
Brong	112727	98620	211347	115180	100967	216147	2.271
Central	113179	101796	214975	115468	104032	219500	2.105
Eastern	150547	135825	286372	154904	140259	295163	3.070
Greater	98542	99106	197648	98142	99204	197346	-0.153
Northern	110394	71016	181410	119388	80843	200231	10.375
Upper East	56308	45640	101948	59522	50551	110073	7.970
Upper West	31692	27089	58781	32007	28619	60626	3.139
Volta	122425	109792	232217	119362	106988	226350	-2.527
Western	118032	106260	224292	120920	107920	228840	2.028
National	1099190	962553	2061743	1123450	991587	2115037	2.585

*Source: Ministry of Education*

The increase in enrolment however, did not occur uniformly across all the ten regions. There was a slight drop in enrolment in the Greater Accra Region and a much more substantial drop in the Volta Region (Table 5.1). The incompleteness of the data available to us makes it difficult to state definitely the reasons for this drop. We can however provide possible suggestions. The first is that private schools have absorbed some of the children in the region. The other possibility is migration from the region. This is unlikely to be a plausible explanation for the decline in enrolment in Greater Accra but may explain part of what is happening in the Volta region. The population growth rate in this region is estimated at 1.8% compared to 4.4% for Greater Accra<sup>15</sup>. The third possible explanation is that there is a decline in the number of children being sent to the first grade. A final possible reason is that there is an increase in the number of children dropping out of primary school. The drop in enrolment in both regions has occurred at the same

<sup>15</sup> The Greater Accra region recorded the highest regional growth rate between 1984 and 2000.

time that there has been an increase in the number of primary schools (Table 5.2).

	<b>1998/99</b>	<b>1999/2000</b>	<b>% Change</b>
Ashanti	1781	1811	1.68
Brong Ahafo	1393	1401	0.57
Central	1140	1166	2.28
Eastern	1790	1884	5.25
Greater Accra	725	751	3.59
Northern	1257	1368	8.83
Upper East	424	444	4.72
Upper West	353	363	2.83
Volta	1415	1429	0.99
Western	1285	1299	1.09
National	11563	11916	3.05

*Source: Ministry of Education*

The highest increases in enrolments were recorded in the Northern Region (10.4%), Upper East (7.9%) and Upper West (3.1%). In all three regions the data suggests that there have been substantial increase in the gross enrolment rates. The trend suggests that more children are entering school and staying longer in school in these regions. These regions have tended to have the lowest gross enrolment rates. The Ministry of Education estimates that gross enrolment rates in the Northern, Upper East and Upper West stood at 45.3%, 41.8% and 50.7% respectively in 1997. What can explain these large increases in enrolments? Again we can at this stage only surmise the possible reasons for this. The increase in enrolment could be a response to programmes run by donors, NGOs and the Government of Ghana aimed at increasing enrolment. In some parts of these regions these programmes began operation quite recently. In the Bawku East and West districts, for example, some primary schools began participating in a school feeding programme run by the USAID and Catholic Relief Services in 1997.

**Figure 5.1: Percentage Change in Enrollment**



The programme also has a component to encourage the enrolment of girls. A monthly dry ration is distributed to the mother of girls who attend school at least 85% of the school days in a given month. These programmes seem to be having some impact<sup>16</sup>. The rate of increase in girl enrolment in the period under review was higher than the rate of increase in the enrolment of boys (Figure 5.1). In addition to the feeding programmes there are also programmes that assist communities in providing school buildings. The number of primary schools increased between 1998/99 and 1999/2000 (Table 5.2). The highest proportionate increase was in the Northern region where the number of public primary schools increased by 111, i.e. about 8%. Thus the establishment of more schools increased access to schools in some communities and this could explain the phenomenon of rising enrolments in that region<sup>17</sup>.

At the primary level there does not appear to be a significant gender gap in the numbers enrolled. The national average of the percentage of girls in total enrolment is estimated at 47.2% in 1999/2000. Girls as a percentage of total pupils enrolled in primary school ranges from 40.4% in

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<sup>16</sup> A concern though is whether enrolment will be maintained if the programmes should be stopped.

<sup>17</sup> It should not be assumed that all the schools that are being counted are complete primary schools. Some may only provide classes for the lower primary.

the Northern region to 49.9% in Greater Accra. An examination of the trend in enrolment between the two years under review finds that the slight decline in enrolment in Greater Accra Region is because of a decline in the enrolment of boys, whilst the enrolment of girls remained fairly constant. These trends suggest either boys are less likely to go to school or stay in school as long as girls are, or else parents are making the decision to send their sons to the relatively more expensive private schools where the quality of education may be higher, whilst the girls are kept in the cheaper public schools. In the Volta Region the enrolment of both boys and girls declined by an almost equal proportion.

It may be observed from Figure 5.1, that in all regions (with the exception of the Western region) where there has been an increase in public primary school enrolment, the enrolment rate of girls is higher than the rate of boys. The difference in the rate of increase between girls and boys is highest in the three poor regions of the North. These trends suggest that there is a need to be conscious of the gender gap in primary education but not necessarily solely from the perspective of societal biases against the education of girls.

### **5.3.2 Quality of Education**

Since 1992 the Ministry of Education has been conducting tests in English and Mathematics to monitor the performance of pupils in primary schools. The Criterion Referenced Tests have been conducted each year except for 1998. The test is administered to a sample of 5 percent of the primary school pupils in class six. The tests are designed to provide information on the learning status of the pupils. They are an indication of how much of the syllabus the pupil knows and understands.

The performance of pupils in public primary schools is poor although there has been an improvement in average scores over time (Figures 5.2 and 5.3). The average scores of the public school candidates are still significantly below the mastery scores of 60% in English and 55% in Mathematics. In contrast, the private schools do significantly better than do their public school counterparts. The average score in English of private school pupils is at the mastery score level. Even though on average the private school candidates do better in mathematics than do their

public school counterparts, their average is still below the mastery score level.

The percentage of students attaining the mastery score in mathematics increased in six regions between 1997 and 1999 (Figure 5.4a). Although the Greater Accra region had the highest percentage of pupils attaining the mastery score, this percentage was lower than the 1997 share (Figure 5.4a).

On the basis of the percentage obtaining mastery score in English the performance of pupils in the Greater Accra region in 1997 was significantly better than the candidates other regions (Figure 5.4b). There has been some catching up by some of the regions, so that the gap in performance between the Greater Accra region and the Upper West region for example, was narrower in 1999. Seven regions registered an increase in the percentage of the pupils attaining mastery scores between 1997 and 1999 (Figure 5.4b). In all seven regions there was an improvement in the mean score of English between 1997 and 1999.

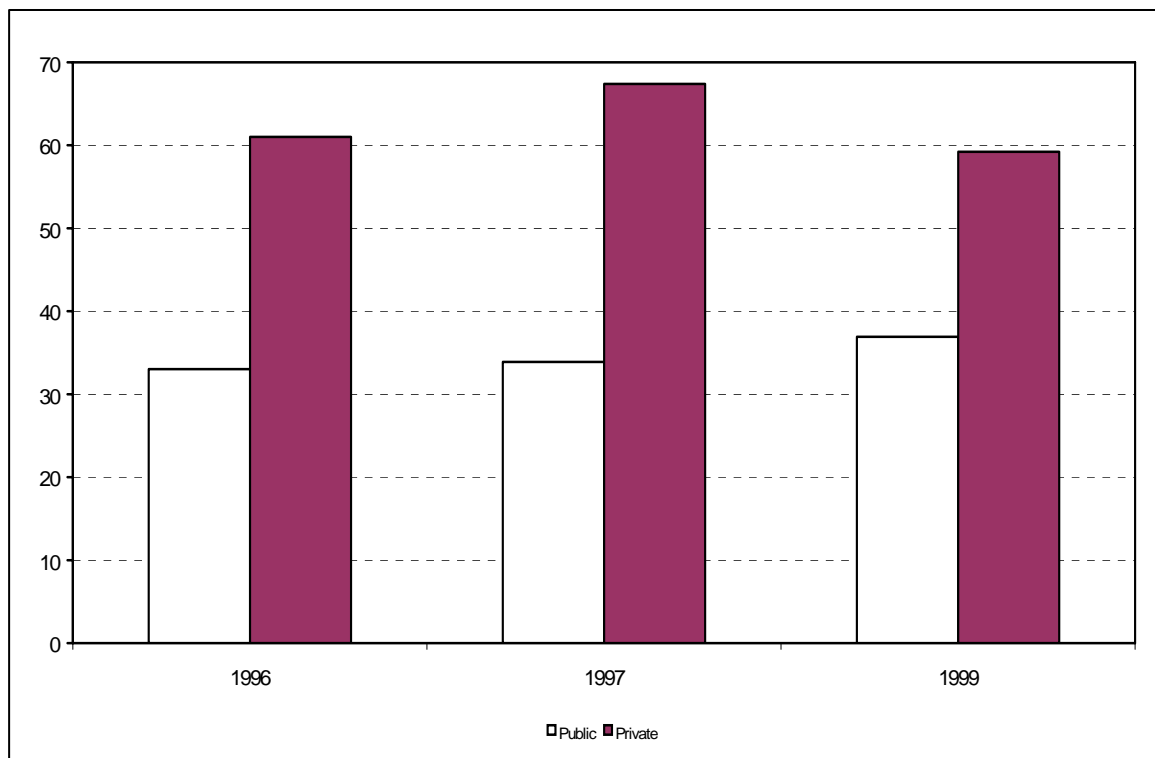
The percentage of students obtaining the mastery score in both English and Mathematics increased in five regions over the period. These are Volta, Northern, Eastern, Central, Ashanti and Brong-Ahafo. The Brong-Ahafo and Northern regions are improving performance from very low levels.

The improvement in performance applies to both boys and girls (Figure 5.5a and 5.5b). It may be observed in Figure 5a that in 1997 the average score for girls in English was higher than boys. Boys have performed consistently better than have girls in the Mathematics test (Figure 5.5b). In 1999, 4.7% of the boys obtained the mastery score in mathematics compared to 3.3% of the girls. The gender difference in performance in both Mathematics and English was found to be statistically significant in 1999<sup>18</sup>.

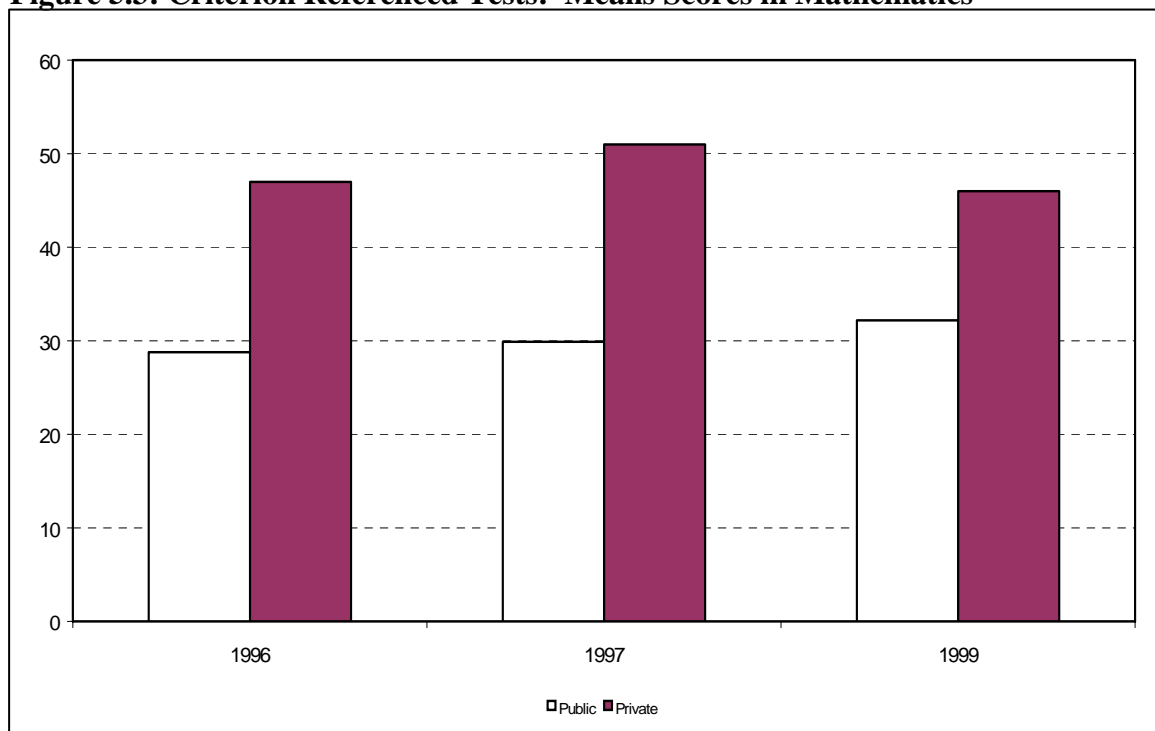
**Figure 5.2: Criterion Referenced Tests: Mean Scores in English**

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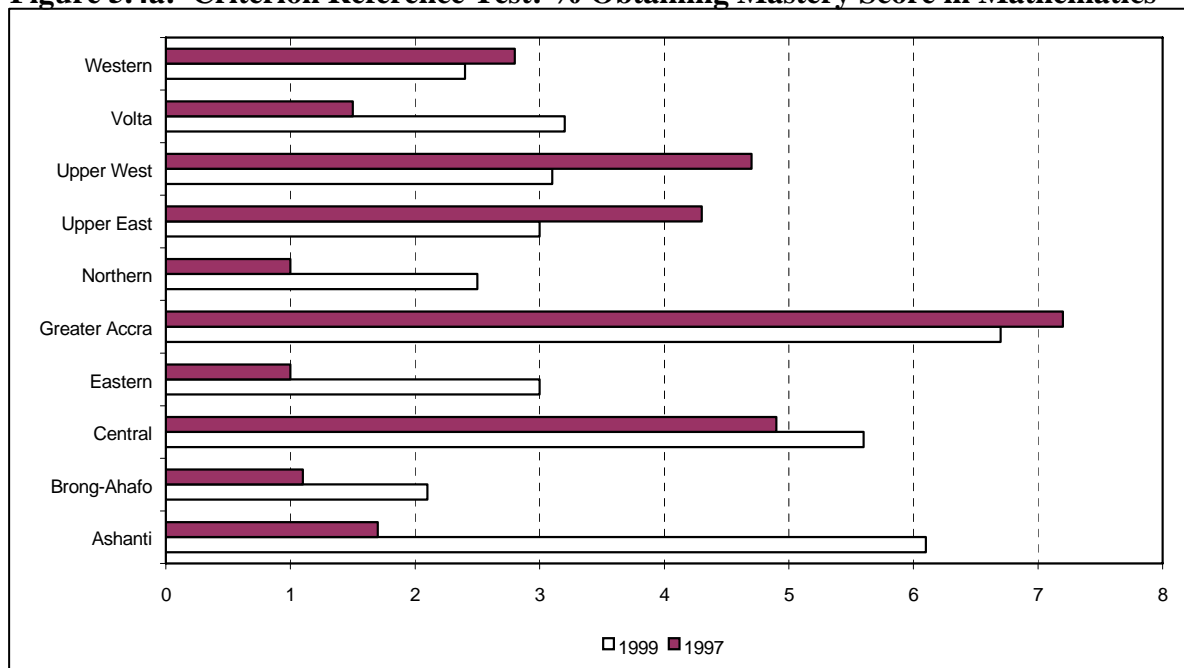
<sup>18</sup> Obtained from report on the Criterion Referenced Tests published by Ministry of Education in Daily Graphic of June 14, 2001.



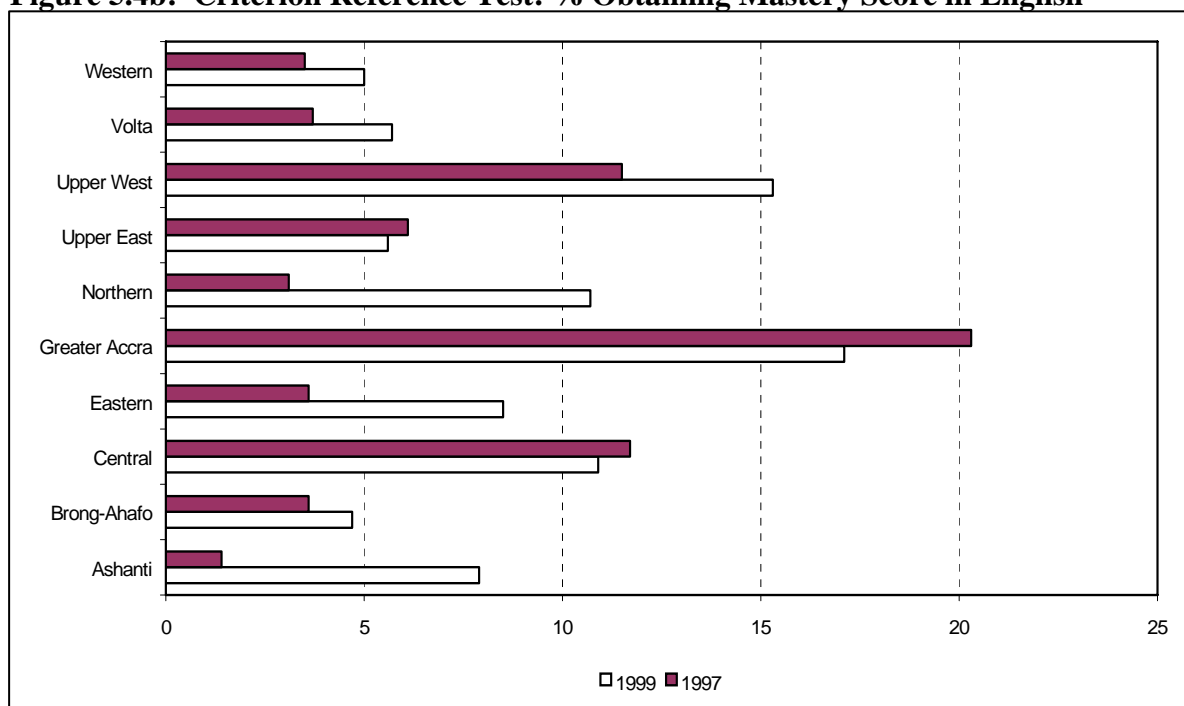
**Figure 5.3: Criterion Referenced Tests: Means Scores in Mathematics**



**Figure 5.4a: Criterion Reference Test: % Obtaining Mastery Score in Mathematics**



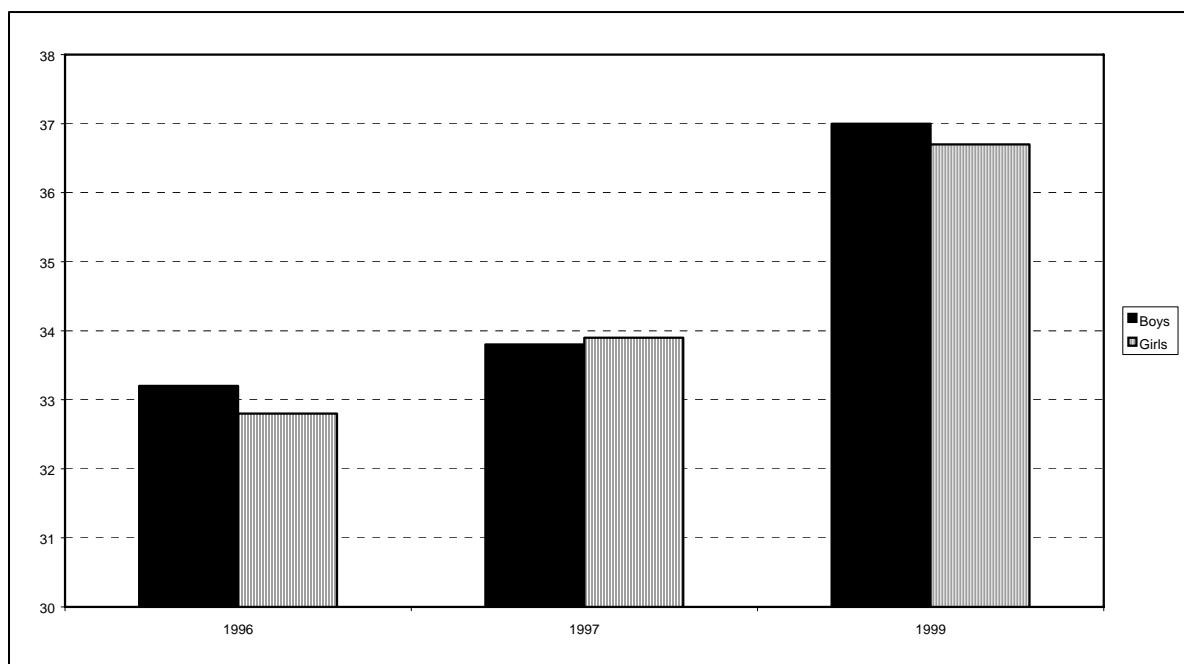
**Figure 5.4b: Criterion Reference Test: % Obtaining Mastery Score in English**



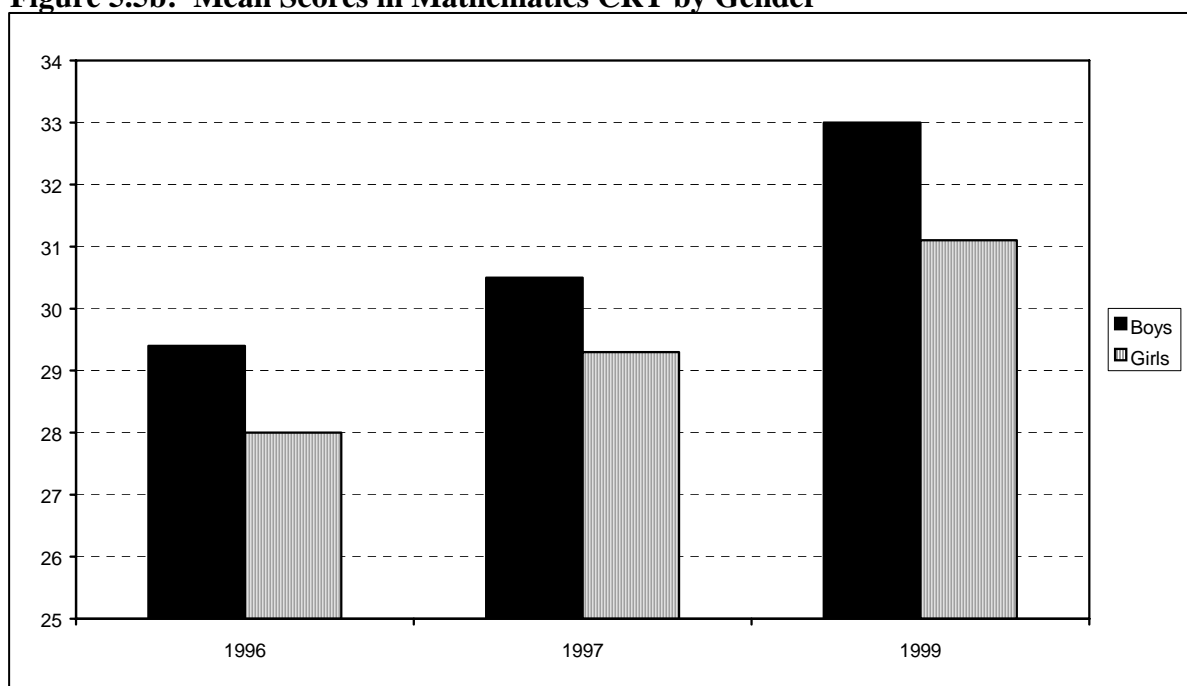
Notes: 1. Mastery Score in English is 60%  
 2. Mastery Score in Mathematics is 55%

Source: Ministry of Education.

**Figure 5.5a: Mean Scores Obtained in English Criterion Referenced Tests by Gender**



**Figure 5.5b: Mean Scores in Mathematics CRT by Gender**



The results of the performance criterion referenced tests are suggestive of inefficiency in the use of available resources. It appears that vast numbers of the children are not benefiting much from the education system because of their inability to understand what is taught them.

### 5.3.3 Junior Secondary School

There was a 1% increase in enrolments in public Junior Secondary Schools between 1998/99 and 1999/2000 (Table 5.3). The Upper East and Upper West stand out as regions where the change in enrolment far exceeded the national average. The Volta region in contrast, was the only region where enrolment rates declined between the two academic years. Because of weaknesses in the quality of data from the private schools it is difficult to ascertain to what extent this drop is due to an increase in private JSS enrolment or due to an overall decline in enrolment in the region.

	Enrolment		Percentage Girls		Enrolment Percent Change		
	1998/99	1999/2000	1998/99	1999/2000	Total	Boys	Girls
Ashanti	139644	140087	0.464	0.466	0.317	-0.048	0.740
Brong Ahafo	70912	71181	0.446	0.446	0.379	0.211	0.589
Central	77876	79684	0.449	0.449	2.322	2.346	2.292
Eastern	101761	102064	0.446	0.448	0.298	-0.133	0.833
Greater Accra	106473	108149	0.492	0.492	1.574	1.524	1.626
Northern	41605	42558	0.324	0.332	2.291	1.064	4.847
Upper East	22860	23870	0.404	0.420	4.418	1.599	8.581
Upper West	15907	16694	0.419	0.427	4.948	3.508	6.939
Volta	80003	79094	0.437	0.439	-1.136	-1.479	-0.695
Western	71273	72870	0.452	0.453	2.241	2.006	2.525
National	728314	736251	0.447	0.449	1.090	0.686	1.589

*Source: Ministry of Education*

The share of girls in total enrolment in JSS is lower than their share in primary school. This is indicative of girls constituting the greater proportion of the dropouts between primary and JSS. There appears to be a particular problem in the Northern region where girls make up only a third of total enrolment in public JSS (Table 5.3). The trends however appear to be less disheartening for girls. In all regions with the exception of Central region, the rate of increase in enrolment amongst girls was higher than that of boys (Table 5.3). The difference was particularly significant in the Northern, Upper East and Upper West regions. In the Volta region where there was a decline in enrolment amongst both boys and girls, it may be observed that the decline was smaller for girls than it was for boys.

	1999			2000			Percent Change		
	Boys	Girls	All	Boys	Girls	All	Boys	Girls	All
Upper West	2740	1842	4582	2682	1758	4440	-2.117	-4.56	-3.099
Gt. Accra	22925	21821	44746	23505	22712	46217	2.53	4.08	3.287
Eastern	17010	12991	30001	16339	12856	29195	-3.945	-1.04	-2.687
Central	13342	10384	23726	13607	10794	24401	1.986	3.95	2.845
Western	12092	9457	21567	12122	9477	21599	0.248	0.021	0.148
Ashanti	24718	20915	45633	25228	21306	46534	2.063	1.869	1.974
Brong	12244	9366	21610	12067	9121	21188	-1.446	-2.616	-1.953
Volta	13871	9763	23634	12873	9493	22366	-7.195	-2.766	-5.365
Northern	8115	3626	11741	7684	3810	11494	-5.311	5.074	-2.104
Upper East	3964	2536	6500	3783	2565	6348	-4.566	1.144	-2.338
Total	131021	102719	233740	129890	103892	233782	-0.863	1.142	0.018

*Source: West African Examinations Council.*

The educational system that begun in 1987 was designed to ensure that children went through nine years of education without an official selection process. This contrasts with the previous education system where an official selection process took place at the end of six years of primary education<sup>19</sup>. Currently, at the end of nine years, all children are required to take the Basic Education Certificate Examination (BECE). The number of candidates that sat for the BECE in 2000 increased by 42 compared to 1999. This is the smallest absolute increase in the number of candidates sitting for the BECE that has been recorded since 1990. This slight increase in the number of candidates is due largely to the decline in the number of boys that sat for the BECE in 2000. The number of male candidates declined in six of the ten regions, i.e. Upper West, Upper East, Eastern, Brong-Ahafo, Volta and Northern Regions (Table 5.4). In the Volta region the number of boys that sat for the examination declined by 7%. In the Northern region the number of boys that took the examination declined by 5% whilst the number of girls that took the examination increased by 5%. At the national level the number of boys that took the examination declined by 1131, i.e. a fall of just less than 1%. The number of girl candidates on the other hand increased by 1.14%. However this increase in the numbers of girls enrolled did not occur in all

<sup>19</sup> Children could sit the common entrance examination to enter secondary school in class six or else enter middle school and sit the examination during the first or second year of middle school.

regions. The number of girls that took the examination declined in four regions between 1999 and 2000 (Table 5.4).

The decline in the number of male candidates may be due to several possible reasons: decision not to take the examination, failure to pay examination fees and a decline in the number of boys that entered JSS 3. For some regions, it is possible that the decline in numbers may be due to migration to other regions. The Volta region stands out in this regard. The decline in the numbers sitting for the examination suggests that the decline in public school enrolments that has been observed at both the primary and JSS level cannot be explained by increased enrolment in private schools. There is either an increase in the drop out rate in that region and/or there is an increase in out-migration. This is an issue that must be investigated further.

This is not the first time that the number of male candidates has declined compared to a previous year. A decline was recorded in 1995. It is important that the trend in enrolment and the gender composition of candidates is monitored. If a situation is emerging where there is a tendency for a growing number of boys to drop out of school and fewer boys are taking the BECE, it is important that the situation is recognized and the explanatory factors are identified so as to deal with the problem in its early stages.

A shortcoming of the BECE as an indicator of the changes in the quality of schooling over time is that the examination is marked to achieve a distribution close to a normal distribution<sup>20</sup>. This method of grading does not make use of objective criteria to assess performance. An individual's grade is assessed on the basis of the performance of the set of candidates who took the examination at the time and not in relation to independent criteria or benchmarks. The results are ranked in descending order and the top 4%-5% constitutes the group that obtains grade 1. In a particular year therefore the top 5% could have obtained marks between 70% and 75%. In the next year however the top 5% could obtain 60%-65%. Both groups will be awarded grade 1 or A but it is quite clear that the performance of the two groups is not the same. Using the Stanine system of grading, there is no relationship between the grade awarded and the mark obtained. It is therefore impossible and wrong to compare the performance of candidates over time because

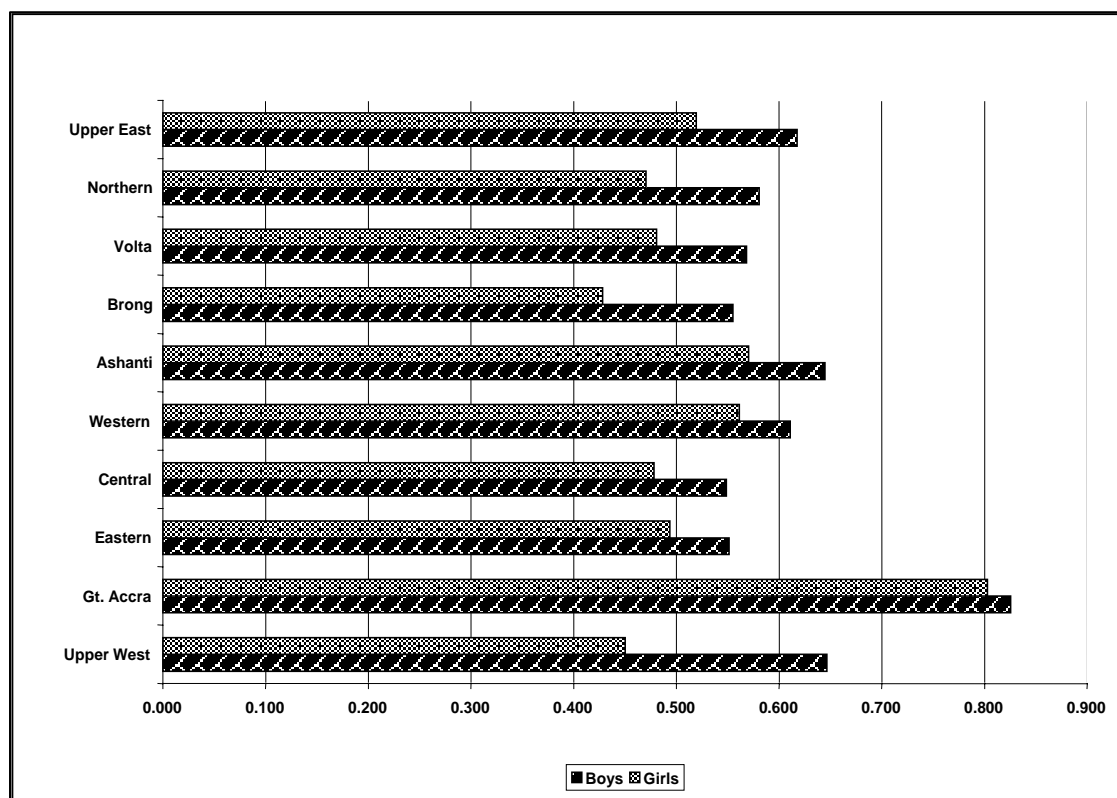
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<sup>20</sup> This is the Stanine system of grading.

there is not enough information to know what is being compared. These shortcomings notwithstanding, it is possible to use the BECE results for comparisons across regions and by gender at a point in time<sup>21</sup>.

Excluding the Greater Accra Region there is no significant variation in the percentage of students obtaining Aggregate 30 or less in the BECE. The proportions range from 50% for candidates in the Brong-Ahafo region to 61% for candidates in the Ashanti Region. The Greater Accra Region emerges as an outlier, because the proportion of students that obtain Aggregate 30 or less is significantly higher, at 81.4%, than is the case for the other regions.

**Figure 5.6: Proportion Obtaining Aggregate 6-30 in BECE**



In all the regions, the proportion of boys that obtain Aggregate 30 or less is higher than the proportion of girls (Figure 5.6). The Greater Accra Region emerges again as an exception. This

<sup>21</sup> This is assuming that candidates are not grouped by region and gender after which the Stanine system is applied.

is because even though a lower proportion of girls in that region obtain Aggregate 30 or less, the proportion of girls obtaining these grades within this region is significantly higher than the proportion of both boys and girls in the other regions that obtain these grades. Thus all candidates in the Greater Accra region, irrespective of gender “do better” in the BECE than do candidates in the other regions.

Keeping the shortcomings of the grading system of the BECE in mind, the analysis of the results by gender and by region raises two issues. There is a need to understand why candidates in Greater Accra perform significantly better than do those in other regions. A similar trend exists for the Criterion Referenced tests in Mathematics in particular, although the gap in performance between Greater Accra Region and the other regions is not as wide as it is in the case of the BECE.

Assessing the performance of candidates using regional data does not reveal the disturbing patterns that emerge when analyzing the situation at the level of the district. Unfortunately we have not been able to obtain information for all the 110 districts. However information obtained from the press and interaction with members of the public reveal that there are several areas where the performance at the BECE leaves a lot to be desired<sup>22</sup>. The fact that **all** candidates from a cluster of villages perform abysmally is an indictment on the current education system. Education is an important means to break the inter-generation cycle of poverty. If an age cohort in a village does not perform well enough in the BECE to be able to pursue higher education this implies that the age cohort is destined for a low level of income. Why is a group of children from one or more than one village in a particular locality not performing well in the BECE? It cannot be that they **all** do not have the intellectual ability to perform well.

Performance in tests is determined by three groups of factors. These are school quality, the family background of the child and the child’s own innate abilities. There is spatial variation in school quality in Ghana. Education policy directly impacts on school quality, so that it is possible for policy actions to be taken to reduce the differences in school quality that exist.

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<sup>22</sup> In a small village six miles from Adeiso in the Eastern region no child obtained an aggregate less than 21 in the 2001 examination. In a village in the Volta region no child obtained an aggregate less than 27.

Family background is the result of the interplay of economic policy and social and cultural conditions. The child's innate abilities are not entirely outside the influence of government policy. Evidence abounds to show that nutrition affects children's learning abilities. Thus policy measures to ensure that children are well nourished in the early critical years of brain development are crucial.

The second important issue raised by the BECE results (and the Criterion Referenced Tests) is the performance of girls. The results of Greater Accra region show that the performance of girls need not be significantly worse than that of boys at the basic education level. There is a need to clearly understand and identify the causes for the significantly poorer performance of girls compared to boys in most of the other regions. The analysis could be conducted within the context of the three factors that have been identified as determining test scores. The importance of each of these three factors on the performance of girls may differ from how they impact on the regional variation of performance. It is important to understand whether family background factors contribute more to explaining the performance of girls than is school quality for example.

#### **5.3.4 The Senior Secondary School System**

After completing basic education, children either enter second-cycle institutions or else enter the world of work. There are two options available at the second-cycle level, i.e. general education and vocational/technical education. If the children are not able to enter any of the second-cycle schools they then have to enter the world of work where they may participate in the apprenticeship and other training schemes that are provided in the work place.

Some senior secondary schools have traditionally provided technical courses. With the present educational reforms the senior secondary school curriculum makes provision for five programmes, i.e. agriculture, business, technical, vocational and general. The general programme comprises of science and arts options. Schools have tended to provide at least two options for the students to choose from. For example in 1998, in the Greater Accra region, only four senior secondary schools offered four programmes. The modal number of programmes offered by schools is three. The secondary-technical schools tend not to offer courses in the general programme.

#### 5.4 General Education

The World Bank provided funding for the Community Secondary Schools Construction Project in 1991. This aimed at providing essential facilities in 140 new senior secondary schools. The new schools were to be located in the educationally deprived areas of the country. As part of the measures to reduce costs, the proportion of boarding to day students in the public senior secondary schools was reduced. A ban was put on the establishment of new boarding senior secondary schools.

In the period since the start of the economic reforms there has been an increase in the number of public schools that enroll both boys and girls. In 1987/88 approximately 18% of the public secondary schools were single sexed schools. By 1999 it was estimated that the proportion of single sexed schools had declined to 7.6%. Although the number of single sexed schools remained the same their proportion declined because the additional schools established with the education reforms were mixed schools. There has been an increase in the proportion of girls enrolled in public senior secondary schools from approximately 33% in 1989/90 to 40% in 1999/2000.

	<b>Number of Schools</b>	<b>Number Enrolled</b>	<b>Percent of Girls</b>
1996/97	465	188908	38.7
1997/98	464	192415	38.7
1998/99	464	--	--
1999/2000	464	204627	40.7

*Source: Ministry of Education*

Presently each of the 110 districts has at least one senior secondary school. The increase in enrolment of girls has probably been influenced by the increase in the number of schools and by the fact that there are now more schools that will take girls. However careful analysis needs to be undertaken to ascertain whether the fact that secondary schools are mixed could create a disincentive in some cultural settings to sending adolescent girls to school. It is possible that enrolment of girls could even be higher if there were more girls' schools.

## 5.5 Examination Performance

At the end of three years students enrolled in the SSS are expected to take the Senior Secondary School Certificate Examination (SSSCE). Performance as measured by the percentage of students that passed the SSSCE, improved after 1994<sup>23</sup>. In 1996 approximately 30% of the candidates obtained between aggregate 6-24. With the improvement in performance emerged a widening in the regional variation of the performance. Thus whereas in 1994 candidates in all regions performed badly, by 1996 significant differences in performance amongst the regions emerged. In that year, 41% of the students in the Central Region obtained at least aggregate 24 compared to 12.5% in the Northern Region. This is a difference of about 28 percentage points. In 1999 the dispersion widened with the Upper East region obtaining a pass rate of 2.6% compared to a pass rate of 35% in the Central Region (Table 5.6).

The proportion that obtained between aggregate 6 and 24 increased between 1999 and 2000. However the increase was not registered in all regions. There was a decline in the proportion that obtained between 6 and 24 in the Western and Upper West regions. The proportion obtaining these aggregates remained virtually unchanged in the Volta Region (Table 5.6).

It is interesting to observe the shift in the region of excellence between the basic education system and the senior secondary school system. The performance of students in the Greater Accra region in the BECE stands out amongst all the regions. However at the senior secondary school level it ranks second place after the Central Region. In 1993 when there was an inadequate supply of inputs, all regions performed badly. With the increase in the supply of inputs a re-emergence of the regional differences is observed. Various possibilities present themselves to explain why this has happened. The first is that there was an unequal distribution in the supply of inputs. Some regions were able to obtain the necessary inputs to improve upon the performance of their students whilst others did not. The second is that there was an

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*23 The results of the first two examinations were extremely disappointing. Overall approximately 3% of the candidates that sat for the examination in 1994 obtained between aggregates 6-36. The best performance was in the Greater Accra Region where about 6% of the candidates passed and the worst was in the Upper East region where the pass rate was less than 2%. There was not much dispersion in the rates amongst the regions. Neither was there much variation on the basis of gender. An almost equal proportion of boys and girls obtained between aggregate 6 and 36 in that year.*

inappropriate mix in the inputs that were made available to the various regions. Some regions may have had both an increase in teachers and supplies, whilst some may have had the supplies but no teachers or teachers but no supplies.

**Table 5.6: SSS candidates that obtained between Aggregate 6 and 24 in 1999**

Region	Number			Percent		
	Boys	Girls	Total	Boys	Girls	Total
<i>Upper West</i>	324	70	394	26.171	13.035	22.197
<i>Greater Accra</i>	2082	815	2897	39.424	17.527	29.171
<i>Eastern</i>	1024	605	1629	20.390	14.336	17.626
<i>Central</i>	1764	1019	2783	42.383	27.370	35.295
<i>Western</i>	635	359	994	27.790	22.133	25.442
<i>Ashanti</i>	1829	649	2478	30.544	15.006	24.028
<i>Brong Ahafo</i>	318	127	445	13.435	9.556	12.040
<i>Volta</i>	825	351	1176	20.512	14.534	18.269
<i>Northern</i>	302	40	342	9.185	3.416	7.670
<i>Upper East</i>	55	14	69	3.188	1.570	2.637
<i>Total</i>	9158	4049	13207	25.886	16.271	21.916

**SSS candidates that obtained between Aggregate 6 and 24 in 2000**

<i>Upper West</i>	243	57	300	20.472	9.005	16.484
<i>Greater Accra</i>	2087	1096	3183	39.237	22.739	31.394
<i>Eastern</i>	1679	1142	2821	33.195	26.121	29.915
<i>Central</i>	1961	1307	3268	45.562	30.986	38.348
<i>Western</i>	641	289	930	27.012	17.547	23.134
<i>Ashanti</i>	2245	1026	3271	35.903	21.500	29.669
<i>Brong Ahafo</i>	520	183	703	20.976	11.686	17.379
<i>Volta</i>	904	327	1231	22.991	12.582	18.849
<i>Northern</i>	431	62	493	12.328	4.526	10.132
<i>Upper East</i>	266	35	301	15.331	3.906	11.441
<i>Total</i>	10977	5524	16501	30.377	20.541	26.180

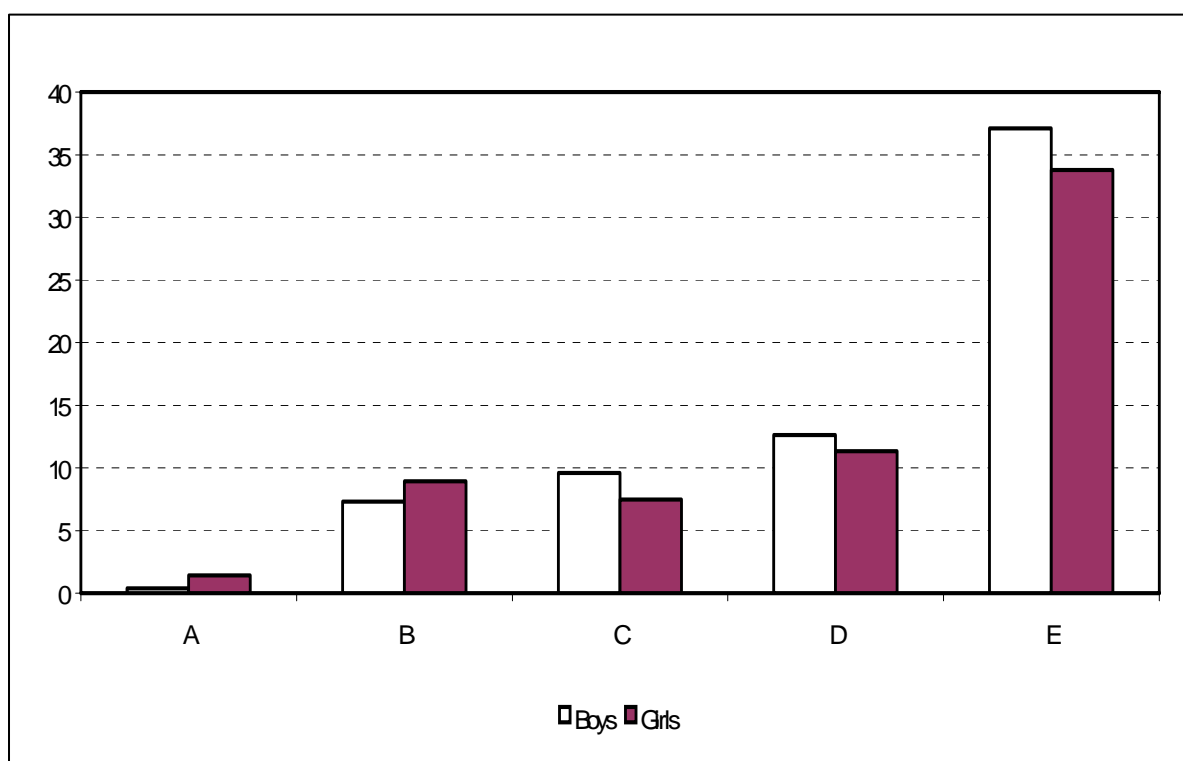
Source: West African Examinations Council

Although there has been an increase in the proportion of students that obtain between aggregate 6 and 24, questions need to be asked about the quality of the pass. In many subjects almost half

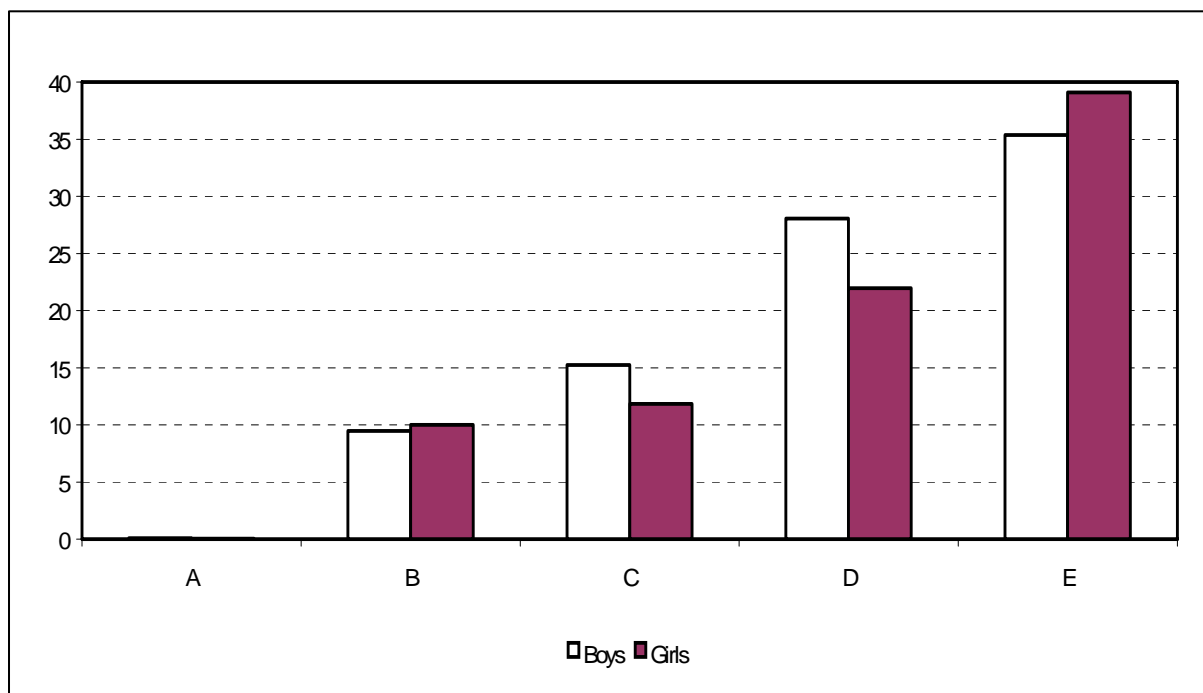
of the candidates that have passed have obtained a Grade E. This is shown clearly in Figures 5.7 and 5.8. These figures present information on the distribution of passes for English and Social Studies for the Central Region in 1999. The Central Region was chosen because it is the region that registered the highest proportion of passes in both subjects.

In some regions no candidate obtains a grade A in some subjects. In 1999, amongst the core subjects, this was the case for the Upper East and Upper West regions where no candidate registered a grade A in English Language. In the same year, no candidate registered an A in Social Studies in Upper West, Greater Accra, Western, Brong-Ahafo and the Northern Regions. This is despite the fact that this subject registered the highest percentage of passes amongst the core subjects. No girl obtained a grade A in Integrated Science in Northern, Brong-Ahafo, Upper West and Upper East regions in that year. In the Northern and Brong-Ahafo regions one boy each obtained a grade A. These are sobering findings.

**Figure 5.7: Distribution of Grades by Gender: English Language in 1999 (Central R.)**



**Figure 5.8: Distribution of Pass Obtained in Social Studies in 1999 (Central Region)**



At the national level, the increase in the proportion of candidates that obtained between aggregate 6 and 24 in 2000 applied to both boys and girls (Table 5.6). In the Upper West and Western regions, however, there was a decline in the absolute number and percentage of girls that obtained these aggregates. In both regions this decline occurred within the context of an increase in the number of girls taking the examination. The Upper West region also registered a decline in the number of boys that sat for the examination. Thus the decline in the absolute number of boys that obtained between aggregate 6 and 24 can be explained partly by this phenomenon. We also observe however that the proportion of boys that obtained this aggregate in the Upper West region also declined so that the low absolute numbers that obtained the aggregates of interest cannot be explained only by the decline in the absolute number of candidates.

In some subjects such as English Language and Social Studies the gender gap has narrowed. In subjects such as Mathematics and Science in which the gender gap persists, the percentage of girls that have passed the examination has been increasing over the years.

In contrast to the BECE where it was observed that there was no significant difference in the performance of male and female candidates in some regions, in particular the high performing Greater Accra region, a similar pattern does not pertain for the SSS level (See Figures 5.9-5.12).

In the 1999 examination, 42% of the boys in the Central Region obtained at least aggregate 24 in the examination compared to 27% of the girls. In the Greater Accra region the percentages were about 40% of the boys and 18% of the girls.

Why is it that on average girls perform less well than do boys? Some have suggested that girls do less well in mixed schools than in single sexed schools. To understand the gender difference in performance and the difference in the performance of girls across regions it is necessary to look beyond whether or not the school is a single sexed school and also investigate the relevance of factors such as family background, the social environment and the school quality. Even though school quality is an important explanatory factor it is not the only one. Would overall performance be better if the students were in boarding facilities? Many of the new schools that were established do not have boarding facilities. The decision to focus on day schools was determined largely by the need to contain costs. However, not all children live in households that are conscious of, or are able to provide the time and space required by children for studying<sup>24</sup>. The fact that children may live in homes that are not conducive for study can also explain their poor performance. Thus poor school quality and a home environment that is not study friendly can result in the deadly cocktail that is currently being served many of the second cycle students. For the policy maker it is important to understand the role or the contribution that each of these variables plays in order to fashion policy measures to redress the situation.

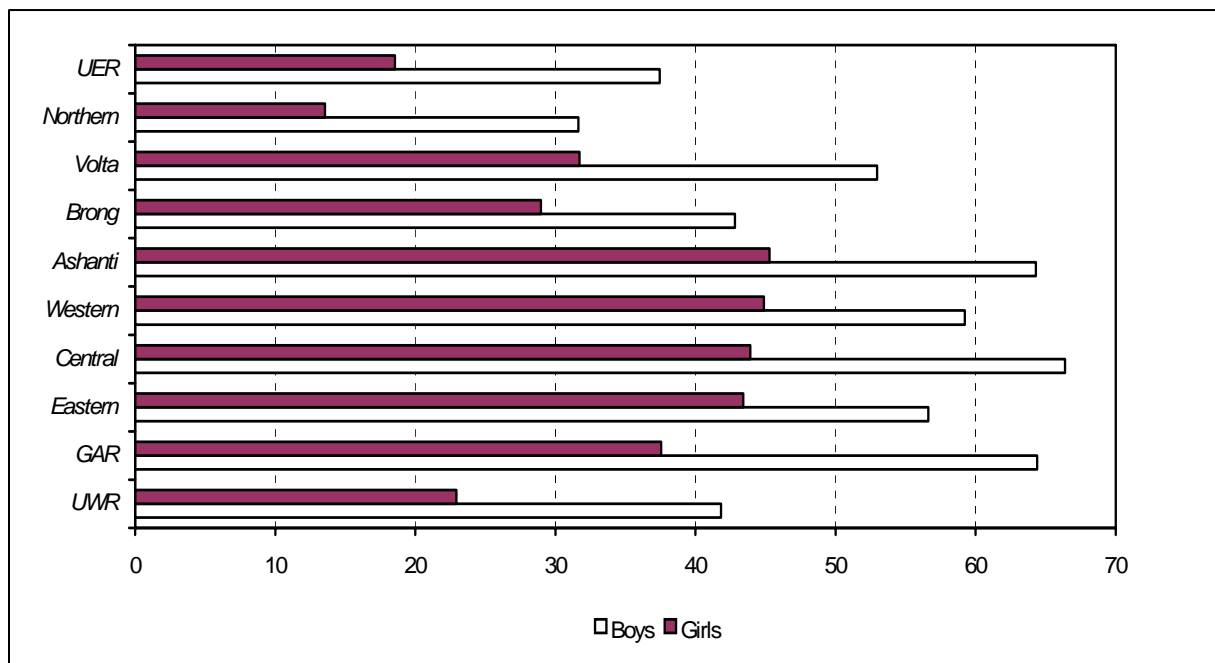
The analysis of the performance at the SSSCE presents two major issues of concern. The first that has been discussed is the gender difference in performance. Second is the issue of location of the school. Why is it that overall the performance of candidates from some regions is significantly poorer than is the case in other regions? A cursory examination of the regional

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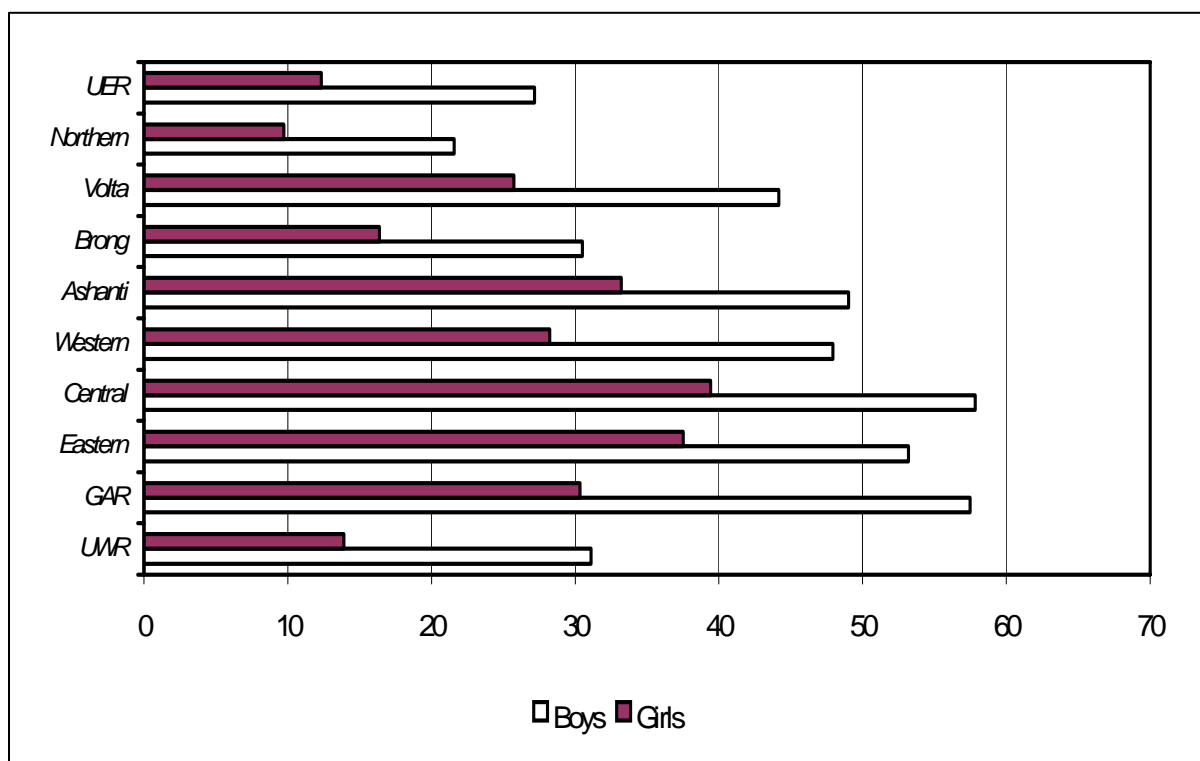
<sup>24</sup> Girls are at a particular disadvantage. Information on time use collected during household surveys shows that girls spend more time on housework than do boys.

performance suggests that the likelihood of a student passing the SSCE is determined greatly by the region in which the candidate attended school. Very crudely the data in Table 5.6 suggests

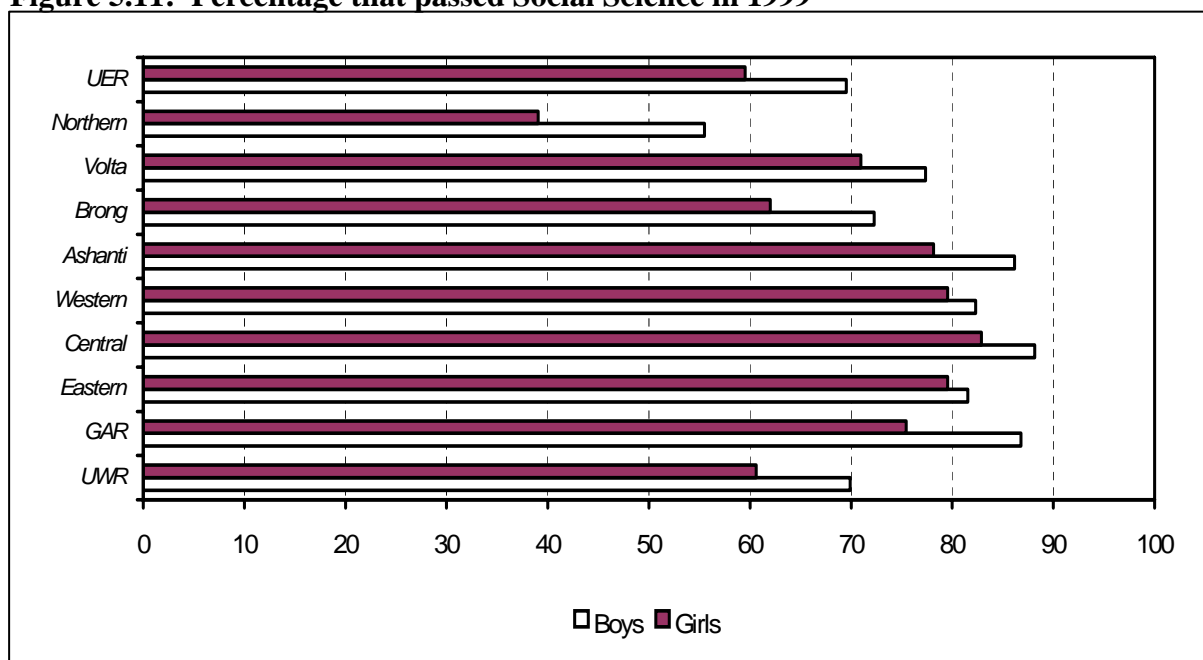
**Figure 5.9: Proportion of Candidates that Passed Mathematics: 1999**



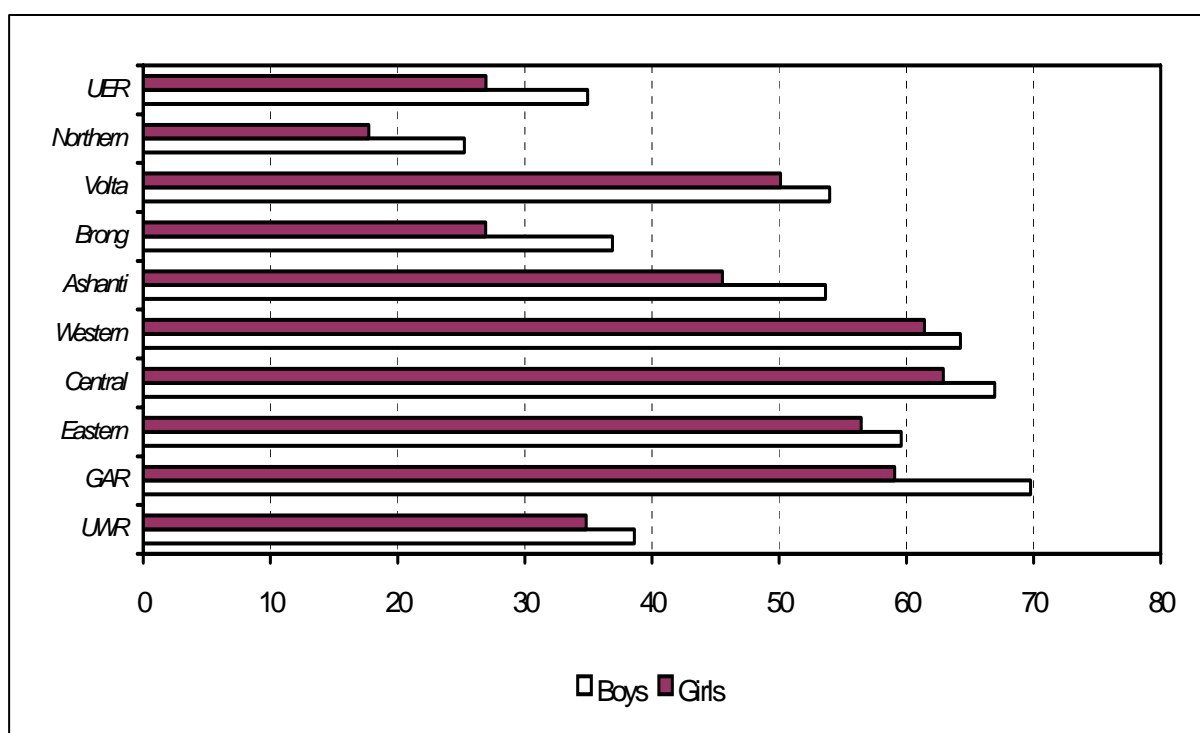
**Figure 5.10: Percentage that Passed Integrated Science in 1999**



**Figure 5.11: Percentage that passed Social Science in 1999**



**Figure 5.12: Percentage that Passed English Language in 1999**



that if a child is sent to a school in Northern and Upper East region there is less than a 15% probability that this child will pass the SSSCE. This difference in performance by region cannot be attributed only to the cultural and socio-economic background of households. These results suggest that the policy of building secondary schools in these regions has not yielded the expected results. This is not to suggest that additional schools should not have been put up in these locations. What it implies is that putting up school structures without ensuring that teachers are well motivated and equipped and that the necessary additional inputs are provided to achieve the expected outcomes will result in the situation that currently prevails in the senior secondary school system in Ghana today.

The poor performance of students in the three northern regions is worrying for another reason. It has been established in studies using data from the second household survey conducted in 1988/89, that the probability of a child attending primary school is determined by the distance of the second cycle institution from the home. If parents in these regions perceive that the likelihood of a child passing the SSS examination is low, they may not be willing to invest even

in primary education. The option to send the child to school in another region may simply not exist for some of these families. They may not have family or friends who will be able to foster the child.

## **5.6 Vocational and Technical Education**

Various ministries, the private sector and NGOs currently manage vocational education in Ghana. The Ministries that are involved in the provision of vocational training are the Ministry of Education, Ministry of Manpower Development and Employment, Ministry of Local Government and Rural Development, Ministry of Food and Agriculture, Ministry of Youth and Sports and Ministry of Environment, Science and Technology.

In 1997/98 there were 23 public technical institutes under the Ministry of Education distributed amongst the ten regions. It is estimated that enrolment in the public technical institutes stood at 16626. Of this approximately 18% of the enrolled students were girls. Unfortunately the data is not reliable so that at present no comment can be made on the trends in enrolment.

The National Vocational Training Institute in 2000 had 27 centers. In 1999, 2080 students graduated from the NVTI centers. Of the total only 17% were women. The NVTI provides training in 25 vocational skills ranging from hairdressing to computer technology. A core-training programme in basic bookkeeping, business management and entrepreneurial skills development is provided.

The private sector dominates the vocational and technical education sector, in particular the informal sector. The apprenticeship training system that is provided at the work place is an important source of skill acquisition. Many of the “masters” have obtained limited training if any from the formal education system and have limited links with technical institutions and polytechnics. The masters may have in-depth knowledge of traditional techniques and technologies but may be at a disadvantage when it comes to knowledge about modern techniques of production, management and organization. An important issue for Ghana during this period of rapid technological change in the world economy is how technology and skills can be transferred

from the rest of the world to the Ghanaian workforce. The informal sector as it is presently organized has tenuous links with the international sources of technology. Enterprises in the sector do not tend to be involved in exporting and there is hardly any sub-contracting between foreign enterprises and local ones. An alternative institutional framework will have to be developed to facilitate the transfer of technology and skills that is needed. Formal technical and vocational education will have to be expanded to increase the supply of masters schooled in modern technologies to the informal sector.

## 5.7 Education Funding and Expenditures

### 5.7.1 Basic Education

The 1987 education reforms introduced changes to the structure of funding education. One of the objectives of the reforms was to ensure financial sustainability of the sector through the containment of costs and sharing of such costs with users. It had become increasingly difficult for central government to provide the necessary funding for education. Under the *f*Cube programme the Government of Ghana is committed to providing free, quality education at the basic level to all children of school going age by the year 2005.

Basic education takes up a little over two-thirds of central government spending in the education sector. Spending by central government on basic education is estimated to have increased by 24.2% between 1999 and 2000 (Table 5.7). With an average inflation rate of 14.5% recorded for recreation, entertainment, education and cultural services during the same period this translates into an increase in real spending in the sector of about 8.5%.

<b>Structure of Basic Education Expenditure</b>		
	<b>1999</b>	<b>2000</b>
Share of Recurrent Basic in Recurrent Expenditure	0.680	0.694
Share of Basic in Total MOE Expenditure	0.670	0.675
Share of Investment in Total Basic Education Expenditure	0.003	0.004
Share of Personal Emoluments in Total Basic Education Expenditure	0.904	0.922
Annual Percentage Change in Basic Education Expenditures		0.242
<b>Other Expenditures</b>		

Share of Secondary Expenditures in Total MOE Expenditure	0.197	0.198
Share of Technical/Vocational Expenditures	0.013	0.013
Share of Tertiary Education	0.118	0.127
<i>Source: Ministry of Education.</i>		

### **5.7.2 Efficiency of Education Expenditure**

Improving the efficiency of education spending in Ghana will require some reallocation of public expenditures within the education sector. Spending by central government is dominated by spending on personal emoluments. These make up approximately 90% of central government spending on basic education. At the primary level the teacher's role is a critical element of the learning process and it is not surprising if teacher's salaries account for the bulk of education costs. At the JSS level the need for teaching and learning materials becomes even greater especially since one objective of the education reforms is for the curriculum to become practical and oriented to the needs of the country. However many schools are not equipped to provide teaching in subjects with a practical element such as Vocational skills, Pre-technical education,

Agricultural Science and General Science. Second, the share going to the inspectorate service, the monitoring arm of the Ghana Education service is quite small. Between them the amount allocated to the Inspectorate Division and to Monitoring and Supervision in the education budget is a little over 1%. For the Inspectorate to operate efficiently staff require transportation to be able to move around the schools and provide frequent monitoring and assessment of the teaching practices etc.

### **5.7.3 Beneficiaries of Education Expenditure**

Studies conducted by the World Bank to identify who benefit from central government education suspending find that children in the bottom 20 percent of the expenditure quintile received less than their fair share of the primary education subsidy<sup>25</sup>. The share taken up by this category of

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<sup>25</sup> The benefit incidence analysis is conducted using data on consumption expenditures from household surveys and data on central government spending on education.

children is estimated to have declined between 1992 and 1998. The proportion of the primary subsidy going to the richest quintile has increased in the same time period.

**Table 5.8. Average Amount paid per Person attending Primary School over a 12 month period**

	Accra	Other Urban	Rural Coastal	Rural forest	Rural Savannah	National	%
<i>School &amp; Registration Fees</i>	136046	47943	13306	23366	3016	34911	28.6
<i>Contributions to PTA</i>	4515	1966	708	1784	1298	1819	1.5
<i>Uniforms &amp; Sports clothes</i>	24683	14533	8896	10564	10244	12482	10.2
<i>Books, School Supplies</i>	30368	11484	4829	6101	3632	9027	7.4
<i>Transport to/from school</i>	18162	7310	3199	2759	82	4973	4.1
<i>Food, board &amp; lodging</i>	121747	58674	40732	42308	14584	49184	40.3
<i>Other expenses<sup>1</sup></i>	27614	11269	4784	3701	1178	7564	6.2
<i>Other in-kind expenses</i>	6057	2970	446	946	2423	2046	1.7
<i>Total</i>	369192	156149	76900	91529	36457	122006	100.0

<sup>1</sup>Clubs, extra classes

Note: the figures are based on those who attended or were attending school in the last 12 months

Source: Statistical Service (2000) Ghana Living Standards Survey. Report of the Fourth Round (GLSS4), Accra

More needs to be done to ensure that the poor, especially the poorest of the poor, are able to benefit from public sector basic education spending. Evidence from Ghana and from other developing countries shows that education can be an effective means to reduce the likelihood of being poor. To benefit from the education subsidies the poor need to send their children to school. The policy of tuition-free education at the basic education level has not been successful in achieving universal enrolment especially amongst the lower income groups. A number of factors can explain this. Tuition fees are not the only costs incurred by the household in sending the child to school (Table 5.8). When the subsidy to the schools from central government is not sufficient to cover running costs recourse is made to households to fill the gap as much as possible. If the household is not able to meet the other costs that need to be incurred if the child is to attend school, then the tuition-free education policy may not be successful in achieving the objective of universal primary education because the very poor may still be left out.

The quality of education that is provided is another factor in the decision to send and keep a child in school and affects the household's valuation of the returns to education. In many farming

communities, children sent to school are expected to be able to read and write in order to read and write letters etc for illiterate members of the household. If the education system is not able to provide these basic skills, the household may consider it unnecessary to send or keep the child in school for very long. Econometric investigation using evidence from Ghana into the causes of low enrolment rates has found that the inferior quality of the education infrastructure particularly in the rural areas can explain the low primary enrolment rates (Lavy, 1992)<sup>26</sup>. Participatory poverty assessments reveal that in some instances parents do not send their children to school if they are not satisfied with the outcome, i.e. ability of the children to read and write (Norton et al, 1995)<sup>27</sup>.

**Table 5.9: Share of Spending on Education by District Assemblies from the DACF**

Region	Basic Education		Secondary Education	
	Mean Share	Standard Deviation	Mean Share	Standard Deviation
Western	0.211	0.124	0.008	0.013
Central	0.284	0.138	0.015	0.031
Gt. Accra	0.204	0.139	0.029	0.036
Eastern	0.272	0.125	0.029	0.047
Volta	0.136	0.064	0.050	0.067
Brong Ahafo	0.208	0.128	0.026	0.036
Northern	0.151	0.096	0.054	0.049
Upper West	0.314	0.119	0.065	0.66
Upper East	0.212	0.152	0.048	0.052
Ashanti	0.206	0.083	0.028	0.023
Total	0.212		0.033	

Source: District Assemblies Common Fund

The share of investment spending in basic education by central government is minimal at less

26 Lavy, V. (1992), *Investment in Human Capital: Schooling Supply Constraints in Rural Ghana*. LSMS Working Paper, 93. World Bank, Washington D.C.

27 Norton, A. E. Bortei-Doku Aryeetey, D. Korboe and D.K.T. Dogbe (1995), *Poverty Assessment in Ghana Using Qualitative and Participatory Research Models*. PSP Discussion Paper Series No. 83, The World Bank, Washington D.C.

than 1% (Table 5.7). This is because investment spending is largely the responsibility of the District Assemblies. At the district level spending on basic education accounts for an average of 21% of the resources of the district assemblies' common fund (Table 5.9). The regional variation may be explained by the priorities of the district and the stock and quality of the district's basic education infrastructure.

A problem emerging with the current division of labour between central government and the district assemblies is one of insufficient co-ordination between the two that can compromise the benefits that should be derived from the district level investments. Central government spending is concentrated on recurrent expenditures whilst the district assemblies' sole responsibility is development or capital expenditures. Lack of sufficient co-ordination between district and central government spending plans has resulted in a situation where the districts may develop the physical infrastructure but the recurrent expenditure needed to effectively utilize the physical infrastructure is not forthcoming.

Thus schools may be built but are not properly equipped with books and other learning and teaching materials. The supply of these materials does not fall within the remit of the district assemblies. The completion of the school or health block for that matter and the demand for complementary recurrent expenditures may not coincide with the central government's plans for recurrent expenditures. There is a need for greater co-ordination between the District Assembly Administration and the district offices of the ministries of health and education.

#### **5.7.4 Secondary Education**

At the secondary level households contribute the cost of feeding students in boarding schools and book user fees have been introduced to cover costs. Households pay a wide gamut of fees approved by the Ministry of Education. These are provided in the tables 5.10 and 5.11. The total sum of the various fees adds up to just over a million cedis a term. In addition to the officially agreed upon fees, the Ministry of Education recognizes that additional fees and levies may be raised by the Board of Governors and Parent Teacher Associations. The Ministry stipulates that

these must not exceed 10% of the official fees. Unfortunately in some instances the guidelines set by the Ministry have not been adhered to. This can be attributed in many cases to insufficiency of central government support.

Despite the payment of a wide gamut of fees, the state still provides a subsidy to the secondary education sector. Approximately 20% of central government spending on education goes to secondary education (Table 5.7). A study to investigate who benefits from government spending on secondary education finds that the households in the upper expenditure quintile receive more than their share of the subsidy on secondary education<sup>28</sup>. Indeed spending on secondary education by central government is regressive. This is because the share of the subsidy increases from the lowest quintile of the population to the highest consumption expenditure quintile. The study also found that between 1992 and 1998 there was an improvement in the share of the subsidy going to the lowest expenditure quintile, i.e. the lowest quintile received 14.9% of the subsidy in 1992, and its share rose to 18.9% in 1998. On the other hand however, the share going to the richest quintile of the population increased from 18.6% to 22.5%.

<b>Item</b>	<b>2000/2001</b>
Admission Fee (ID Card, Exeat card, library card etc.)	25,000
Feeding Fee (Boarders)	840,000
General Stationary Fee	15,000
Examination (stationary) fee	36,000
Library Fee	15,000
First Aid Fee (Boarders)	9,000
First Aid Fee (Day)	6,000
Building Maintenance Fee	30,000
School Uniform fee (2 sets)	Not more than 80,000
Sports Fee	9,000
Utility Charges	To be determined by Board of

28 Canagarajah, S. and Ye, X. (2001) *Public Health and Education Spending in Ghana 1992-98: Issue of Equity and Efficiency*, The World Bank, Washington D.C.

	Governors
SRC Dues	3,000
Entertainment (Boarders)	6,000
Entertainment (Day)	3,000
Sanitation & Environment (Boarders)	15,000
Postage	2,000
Report Book & Cumulative Records booklet <sup>1</sup>	25,000
<sup>1</sup> Payable only once on admission	
Source: Ministry of Education.	

These figures suggest that if individuals from poor backgrounds are to be able to participate in secondary education and therefore benefit from central government spending in that sector, it is critical that programmes be developed to target individuals from these groups. The programmes should not focus only on reducing the direct cost of secondary education to the individual. It should also concentrate on improving upon the quality of secondary education that is provided. If the quality of schools in a locality is low and individuals assess that the likelihood of qualifying to obtain a certificate is low, the demand for secondary education is not likely to increase by as much as expected even if direct costs are reduced significantly. This is because there is an opportunity cost to going to school. These costs form part of the individual's decision as to whether or not to continue with education.

<b>Item</b>	<b>2000/2001</b>
Textbook User Fee	20,000
Practicals/ Materials Fee	
Science Elective	60,000
Core Science	15,000
Technical	36,000
Furniture Maintenance and Replacement (Classroom)	15,000
Bed-User-Fee (Boarders Only)	6,000
Vocational Program (Home Economics, Visual Arts) Fee	Not more than 20000 per term
Use of Science Resource Centers	12,000
Source: Ministry of Education	

## 5.8 Conclusion

The higher rate of increase in enrolment of girls compared to boys suggests that progress is being made in closing the gender gap at the basic education level. Two caveats though are in order. The first is that girl enrolment rates are still significantly lower than boys in many regions. The second caveat is the worrying phenomena of the decline in the enrolment of boys in some regions and a fall in the number of boys that sat for the BECE. Thus in some locations the closure of the gender gap is because of falling enrolment amongst boys. The reasons for the declining enrolment of boys need to be understood and policies introduced as soon as possible to address the situation.

The *f*CUBE programme has three components. These are improving the quality of education, improving the quality of education management and improving access to basic education. There needs to be more commitment and greater effort in ensuring that these components of the programme are implemented. It must also be realised that the three components are interrelated. Access to education will not be improved if the children are not provided with quality education. Improving the quality of education management is critical to ensuring that there is quality education.

The quality of education in primary school as measured by performance in the Criterion Referenced Tests is low. Test scores have been improving since 1992 but are still very low. The better performance of private school pupils compared to public school pupils suggests that school quality has a heavy weight amongst the factors explaining performance in the examination. Injecting more resources into the primary education sector is not the only solution to dealing with

the issue of poor school quality. Other factors are critical in ensuring an improvement in quality. The first is the quality of the teaching staff. Whether teachers have attended teacher training college and the quality of teacher education are important factors in influencing the capacity of teachers to understand the curriculum and deliver it in the classroom in a format that will be comprehended by the pupils. Other variables that affect school quality are the availability of teaching and learning materials, the organization and management of the school and the extent of

teacher supervision. Greater participation of parents and guardians in the management of the schools could also improve upon monitoring of and use of resources available to the schools.

Improving upon the quality of education requires that there is an effective monitoring system. The BECE provides an excellent opportunity to monitor the output of the junior secondary schools. However the choice of the Stanine system for evaluation of examination has made it impossible to utilise the examination for this purpose. It is recommended that the marking system of the BECE be reviewed so that the examination can be used for monitoring purposes.

At the primary, junior secondary and senior secondary levels there is clear evidence of inequality in the education system. The locational inequalities as reflected in regional differences in examination performance in examination are stark. The regional differences in examination performance that are evident at all levels of the education ladder are indicative of regional differences in school quality. Migration to areas with higher school quality is a likely response to these phenomena. Not all people born in regions with comparatively lower levels of education can migrate or else send their children to live with relations or friends in other regions and districts. It is therefore imperative that measures are implemented to ensure a standardisation of quality in the public school system in all districts and localities of the country.

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