



CENTRE FOR POLICY ANALYSIS

**GHANA
MACROECONOMIC
REVIEW AND OUTLOOK**

2000

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Centre for Policy Analysis

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Table of Contents

1. EXECUTIVE SUMMARY AND OUTLOOK.....	Page 1
2. REVIEW OF THE AGRICULTURAL SECTOR.....	Page 13
2.1 Rainfall Distribution.....	Page 13
2.1.1 The Guinea Savannah Belt.....	Page 13
2.1.2 The Transition Belt.....	Page 16
2.1.3 The Forest Belt.....	Page 17
2.1.4 The Coastal Shrub and Grassland Belt.....	Page 18
2.2 Institutional Setting - ASIP and AgSIP.....	Page 18
2.3 Infrastructural Setting.....	Page 21
3. REVIEW OF THE INDUSTRIAL SECTOR.....	Page 24
3.0 Introduction.....	Page 24
3.1 Developments in the Mining Sector.....	Page 30
3.2 Developments in the Steel Sub-Sector.....	Page 33
3.3 Developments in the Beverages Sub-Sector.....	Page 35
3.4 Developments in the Cement Sub-Sector.....	Page 37
3.5 Conclusion.....	Page 38
4. REVIEW OF PUBLIC FINANCE AND FISCAL OPERATIONS.....	Page 41
4.0 Introduction.....	Page 41
4.1 The Fiscal-Monetary Nexus: A Historical Perspective.....	Page 41
4.2 The National Economic Forum and the Budget.....	Page 43
4.3 Measures of Fiscal Stance.....	Page 44
4.4 Overall Assessment of the Fiscal Stance.....	Page 46
4.5 Financing of Government's Fiscal Operation.....	Page 50
4.6 Domestic Revenues.....	Page 52
4.7 Government Expenditures.....	Page 57
5. REVIEW OF MONEY, PRICES AND FINANCE.....	Page 63
5.0 Introduction.....	Page 63
5.1 Monetary Management.....	Page 63
5.2 Developments in Money.....	Page 69
5.3 Developments in Prices.....	Page 72
5.4 Financial Market Developments.....	Page 76
5.5 Developments on the Capital Market.....	Page 79
6. REVIEW OF TRADE AND PAYMENTS.....	Page 84
6.0 Introduction.....	Page 84
6.1 The Foreign Exchange Market.....	Page 85
6.2 The Balance of Payments.....	Page 92
6.3 Trends in Exports.....	Page 95
6.4 Trends in Imports.....	Page 99
6.5 External Debt and Debt Service.....	Page 101

List of Tables

Table 2.1: Precipitation in Sahel & Guinea Savannah Areas.....	Page 14
Table 2.2: Rainfall Distribution in Selected Centres.....	Page 17
Table 3.1: Enterprise Failures By Region.....	Page 29
Table 3.2 : Estimates of Mineral Ore Production and Sales in Ghana.....	Page 30
Table A1: Comparative Enrolment Rates in Education.....	Page 40
Table 4.1: Indicators of Fiscal Stance.....	Page 47
Table 4.2: Financing of Government Fiscal Operations.....	Page 50
Table 4.3 : Domestic Revenue Performance.....	Page 52

Table 4.4: CEPS Tax Collections	Page 54
Table 4.5: IRS Tax Collections	Page 54
Table 4.6: Value-Added Tax Collections	Page 55
Table 4.6: Aggregate Expenditure Performance	Page 58
Table 5.1: Money Supply and its Sources	Page 69
Table 6.1 : Nominal and Real Rates of Depreciation	Page 87
Table 6.2: External Payments and Exchange Rate Misalignment Indicators	Page 90
Table 6.3 : Balance of Payments Account	Page 93
Table 6.4: Trends in Overall Imports	Page 100
Table 6.5 : Ghana's External Debt Stock.....	Page 101

List of Figures

Figure 3.1: Bank Credit and Real Interest Rate Trends	Page 26
Figure 3.2: Enterprise Failures and Unemployment	Page 27
Figure 4.1: Indicators of Fiscal Stance	Page 48
Figure 5.1: Monetary Management	Page 64
Figure 5.2: Inflationary Trends	Page 72
Figure 5.3: Percentage Changes in the Major Components of the CPI	Page 75
Figure 5.4: Spread between Savings and Lending Rates.....	Page 77
Figure 5.5: GSE Company Performances	Page 80
Figure 6.1: Spread between and within Foreign Exchange Markets.....	Page 89
Figure 6.2: Exchange Rate Misalignment and Trade	Page 91
Figure 6.3: World and Realized Commodity Prices of Ghana's Major Exports	Page 96
Figure 6.4: Trends in Trade and Payments	Page 98

List of Boxes

Box 3a: Trends in Enterprise Failures and Employment.....	Page 29
Box 3b : "Competitive Pressures" from Inefficient Producers	Page 34
Box 3c: The Venezuelan Experience in Steel Production	Page 35
Box 3d: Importance of Education in Ghana's Development	Page 40
Box 5a: An Illustration of Liquidity Management of Cocoa Credit.....	Page 66
Box 5b: New Requirements for Bank and Non-Bank Licences	Page 78

1. EXECUTIVE SUMMARY AND OUTLOOK

The performance of the economy in 1999 was adversely impacted by sharp exogenous shocks – inclement weather developments and deterioration in the commodity terms of trade – and continued serious policy slippages. As a result real GDP growth fell considerably short of projections and inflation – measured by the official CPI-resurged.

There were also delays in the disbursement of aid which heightened fears of devaluation of the cedi. In the event the further tightening of monetary policy with interest rate increases to help shore up the exchange rate proved too little too late. In the last two months of the year the cedi depreciated by 24 percent in the interbank market. Thus by the end of the year the cedi had depreciated enough to correct for the earlier over valuation of the currency; yet, the foreign exchange market could not clear. As a result, the overall balance of payments deficit reached a staggering US\$305 million.

In the real sector, agricultural output and farmer incomes suffered from a massive armyworm invasion and extensive flooding in the three northern regions of the country that constitute the Guinea Savannah Agricultural Belt. The armyworm invasion – the result of an unexpected hot spell – occurred in April and May and was both sudden and severe. All seven administrative districts of the Upper East Region were affected as also half of those in the Northern Region. Hard data on the extent of damage are not available but preliminary estimates from the Ministry of Agriculture place losses in cereal production at 5 per cent of what was projected for the year for the Guinea Savannah Belt.

In addition, the Savannah Belt was also hit by high amounts of rainfall which resulted in extensive flooding – the worst in recent memory. Production losses were high whilst the disruption in transport network brought added marketing losses as farmers were left stranded with large stocks of perishable produce. For eight weeks between September and November, large areas of the most affected administrative districts could only be reached by air and to a lesser extent by canoe. The disaster included the destruction of production infrastructure as well as breeding and planting stock.

In the Forest Belt, the cocoa farmers fell victim to a combination of the terms of trade shock, policy slippages in respect of the exchange rate and the producer price setting regime. Real farmer incomes were eroded by about 15 per cent on official estimates. The same combination of factors produced a substantial loss of cocoa export tax revenues to the Budget. The beneficiary in all of this was the banking system and other operators in the foreign exchange market who gained access to official foreign exchange and sold to clients at much more depreciated transaction rates.

Given the unique Ghanaian experience of 1998—the "power shock"—and the positive response by both government and the private sector—CEPA was optimistic that a more stable macroeconomic environment supported by a more stable supply of power would result in higher levels of production in the key sectors of industry in 1999 than prevailed in 1998. In its *Ghana Macroeconomic Review and Programme 1999*, CEPA had projected that electric power production would stabilize at least at the levels prevailing in the second half of 1998. Consequently, capacity utilization and production levels in the key sectors of Industry (Metal Products, Mining, Food and Beverages) were expected to be higher, than in the comparable period of 1998.

Trends in financial indicators—growth in credit to the private sector, declining nominal rates of interest—would suggest a private sector-led boom. However, the positive financial sector indicators must be interpreted with caution. As was most aptly demonstrated by the East Asian crisis, high growth rates in credit to the private sector, could equally be indicative of an economy in financial distress with a rising stock of unserviceable loans. Ghana's own experiences in the seventies with a rapid build-up of non-performing assets in the banking system which necessitated a bailing out through the NPART provides further illustration.

In the Ghanaian example, a significantly large share of the incremental credit to the private sector has been government "proxy" borrowing—the counterpart to rising stock of payment arrears and not funds directed at augmenting the stock of productive capital. Since about the third quarter of 1995, the share of bank credit to the private sector, in consequence,

has grown rather sharply.

Moreover, the real cost of capital—the bank lending rate adjusted for inflation—the relevant variable for investment decision making, has remained burdensome, averaging over 20 percent in 1999. Indeed, since September 1996, real lending rates, have remained positive, high, and on an upward trend. For a nation with a growth rate of real income of between three to five percent, such high lending rates are clearly onerous and could have served to deter investment with serious adverse consequences for future growth potential.

These developments—high and rising real rates of interest together with a sharply depreciated cedi— in the short-term, tend to increase the domestic costs of production, with a consequent loss in the competitiveness of domestic producers. Over time the rate of enterprise failures begins to rise with its attendant adverse implications for employment and growth.

In the absence of a viable market for longer-term investment funds (the stock market in its current state does represent a viable alternative), commercial bank lending (with its onerous burden) will admittedly remain the most viable alternative for investors at least on the local market. From a policy viewpoint, there is thus an urgent need to examine the extent to which funds such as those available at SSNIT and other public or private non-bank financial institutions — insurance companies, provident and mutual funds — can be channeled at lower costs to support longer-term investments in Ghana.

Ghana's current economic problems, in a fundamental sense, have their origins in the lack of complementarity between fiscal and monetary policies. The situation arises from the failure to develop a culture of sustainable internalised fiscal discipline. As a result fiscal pressures which resurged in the latter part of 1998, intensified in the first half of 1999 and appeared to have persisted through the end of the year. The adverse external terms of trade shocks of 1999 thus contributed to an already deteriorating underlying situation. In the event, the lost opportunity in 1998 to build the CEPA-proposed Cocoa Buffer Fund to cushion the economy from the predicted adverse shocks of 1999, appears even more regrettable.

The current economic malaise can also, in part, be attributed to the economic management philosophy adopted in recent years. Since the end of 1995 when the year-on-year inflation rate reached 71 percent, the authorities and our foreign collaborators have made inflation public enemy number one. Although there are several ways of fighting inflation, some unfortunately create problems of their own. Consciously or otherwise, the policy mix chosen has led to high cost of credit for business, difficulties in gaining access to credit and, in the last four years, a perverse case of crowding out of the private sector through payment arrears and non-payment of bills to businesses and individuals. The payment arrears have manifested themselves in increasing private sector credit from the banks. For those businesses that were not able to seek accommodation from the banks or their creditors, the crowding-out process has led to enterprise failures and rising unemployment (even if only by casual empiricism), resulting in an increasing incidence of social distress. The latter has, undoubtedly, influenced attitudes towards payment of fees in connection with schooling and health care, among other things.

Meanwhile, there was an uneasy calm in the financial market for most of the year, with the capital market in particular demonstrating a dullness in performance very much in contrast with the year before. Monetary management in 1999 continued to be restrained in the face of dire fiscal constraints, with complete and almost contemptuous disregard for other developments in the economy. The result was that all the financial indices continued to show positive trends without yielding the required response from the real side of the economy. Money was squeezed to minimal growth, the rate of inflation continued to show declining trend as was the nominal rate of interest, while the nominal exchange rate appeared stable; yet stock market activity and investment response was very poor. One supposition is that the economy of Ghana is still very much public sector driven. Consequently, a slow-down in public sector activity due to fiscal inadequacies forces other sectors to also slow down. Moreover, when monetary policy reduces to liquidity management, it institutes a dichotomy between the nominal and real sides of the economy.

The financial institutions, which have been making gains by investing mostly in government paper, have not helped to resuscitate the real sector either. Rather, some of their activities may be contributing to financial disintermediation in the country. In particular, the two large foreign-owned commercial banks have adopted a policy of trimming away small

depositors. Saving depositors with these two institutions whose balance fall below 500,000 cedis are made to pay a “Savings Maintenance Fee” of 4,000 cedis a month. Thus by being a small saver with these banks, not only is the depositor losing interest but also he/she is penalized!

On the external front, it should be recalled that in 1998, Ghana experienced an export boom. Yet six months after the boom, Ghana was confronted with a foreign exchange crisis. The crisis manifested itself in a run-down of international reserves, lengthening queues for foreign exchange in the Deposit Money Banks (DMBs), increases in the premium on foreign exchange, as parallel market operators gained in profitability, and a huge nominal depreciation of the cedi. By the end of 1999, the exchange rate had experienced its heaviest nominal depreciation since Ghana adopted the float in 1991, in spite of massive intervention by the Bank of Ghana. Consequently, gross reserves, in terms of months of imports cover, had fallen to their lowest since the mid-eighties.

The crisis was predictable on the basis of economic fundamentals and manifested the incoherence in macroeconomic policy formulation and implementation. In its 1998 review, CEPA drew attention to the signs of the impending crisis. These included the increasing real overvaluation of the currency over the last four years and the widening and unsustainable current account deficits. The dangers of using the exchange rate as an inflation anchor by running down Ghana’s reserves to precariously low levels was also shown. These together with the resurgence in inflation, in spite of exchange rate anchoring, low levels of continuous capital inflows and creeping controls were symptomatic of an incipient economic crisis. The external shock of 1999 (terms of trade deterioration) only intensified the manifestation of a crisis that was always coming.

The experience reveals in stark form, the fundamental vulnerability and fragility of a commodity-dependent economy. It also points to the need for a longer term perspective in the management of such an economy. The short-term management framework, with bursts of expenditures following export booms to be followed by impending crisis on the reverse side of the economic cycle the next year, is dangerous for such an economy. Furthermore, it reveals the dangers of using the exchange rate to achieve inflation targets in circumstances of weak and low

international reserves position. The dis-incentive effect of such misaligned and artificially low exchange rates make the replenishment of reserves and the maintenance of the rate through exporting difficult, creating international aid dependence.

Economic Outlook: 2000-2001

The Outlook for 2000 and 2001 is predicated on three main factors: (a) outstanding economic issues, (b) reaction of the international donor community, and (c) political exigencies.

(a) Outstanding Economic Issues: The review of the performance of the Ghanaian economy in the other parts of this report shows that there are quite a number of outstanding issues which will have to be tackled by the government. The manner in which these issues are handled will determine the country's economic fortunes for this year and the next. These include:

(i) Weak fiscal position: The fiscal is in a precarious position which is camouflaged with the non-payment of government bills. This has led to a rising stock of payment arrears in the system and consequently to a situation of non-completion of projects and a threat to the financial system.

To give an impression of efforts at solving the fiscal problem, there is an attempt to increase the VAT rate from 10 percent to 12½ percent. As analyzed in the review section of this report, CEPA does not see the wisdom in increasing the VAT rate, while there appears to be an opportunity of an increased collection if the base is broadened by the removal of thresholds, with a consequential closure of the domestic market to smuggled imports.

(ii) Declining terms of trade: In 1999, the declining prices of cocoa and gold on the world market and rising prices of imported oil caused a weakening in Ghana's terms of trade. This did not only lead to a poor fiscal position but also deterioration in the country's balance of payments position. There was thus pressure on the exchange rate to

depreciate. As often happens, the panic created by market uncertainties led to an overshooting of the equilibrium exchange rate.

The external payments crisis that confronted Ghana in 1999 may continue into 2000 and beyond. With continuing low cocoa prices, uncertain world market conditions for gold and high oil prices, the unfavourable terms of trade will continue throughout 2000 with adverse consequences for the current account.

The crisis of 1999 and the unsustainable macroeconomic fundamentals prior to 1999 have created unfavourable conditions for autonomous private capital inflows. This is compounded by the fact that 2000 is an election year with all the associated economic uncertainties. The capital accounts situation will therefore depend on donor disbursements.

The economic crisis facing Ghana requires both an adjustment and temporary financing of the short-term consequences if Ghana is not to slip into a reversal of hard won economic reforms.

(iii) Illusory monetary policy: The monetary authorities cannot be expected to relent their resolve to strive for the achievement of the financial targets within the ESAF, the fiscal and terms of trade difficulties notwithstanding. Thus, a tight monetary policy should be expected for the year 2000. This will lead to a further worsening of the fiscal problem and a stifling of real sector activity. Further, the expected continued tightness in monetary policy will not be able to hold inflationary pressures down, as the cost push pressures generated by the macro instability will force inflation on an upward trend. It is important to note that the three-year business cycle for Ghana already predicts an underlying inflation set on an upward trend. It should be emphasized that much as there is the need for monetary policy not to accommodate fiscal indiscipline, a tight monetary stance in the face of a huge budgetary gap implies further macroeconomic destabilization.

(iv) *Labour market issues:* In 1994, Government employed the services of a firm of management and accounting consultants, Price-Waterhouse, to design a system for the rationalization of salaries in the country. While the project was being undertaken, salary negotiations were suspended and in spite of rather sporadic rates of inflation, average annual increases in salaries in the public sector were limited to about 20 percent. Thus, over the years, real earnings have been seriously eroded. In 1998, when the Price-Waterhouse report was released it was realized that it had failed to address a number of labour market issues. In particular, it failed to recommend acceptable salary scales as workers had been made to believe. Moreover, the implementation of the recommendations in 1999 proved even more problematic.

The insistence of labour for higher wage increases in 2000 will throw an already fragile fiscal situation out of gear.

(v) *Social issues:* Subventions to the education and health sectors, and cost recovery as well as cost sharing in these sectors are still unresolved issues whose resolution may impact on the fiscal and hence on the whole macroeconomy.

- (b) **Reaction of the International Donor Community:** Ghana has some obligatory relationships with the international financial community, particularly the Bretton Woods institutions. Ghana is still under the ESAF programme signed with the IMF in 1998 and in November 1999, the World Bank led the country at a Consultative Group meeting to secure grants for budgetary and balance of payments support from the international donor community. Following the East Asian financial debacle, the IMF is likely to have intensified its surveillance over member countries and is less likely to grant waivers for the tripping of performance criteria and benchmarks agreed to in the ESAF. Further, some promises were made by the Government of Ghana at the Consultative Group meeting to secure the pledges from the donor community. Thus, if the Government must maintain credibility with the donors, then monetary and fiscal policies are likely to be tight for 2000 and 2001.

- (c) **Political Exigencies:** 2000 is an election year. As with 1992 and 1996, there are likely to be pressures for unbudgeted expenditures which will widen the already large fiscal gap.

Clearly, the economic outlook for 2000 does not appear good. There are difficult choices to be made. The policy options are very limited: either there is an induced recession to muffle demand, or the exchange rate is allowed to depreciate to eliminate the external imbalance. Both extremes are untenable in an election year. A bit of both plus substantial help from the donor community would be needed to stabilize the macroeconomic environment.

As a practical matter, the National Economic Forum (NEF) recommendation of a balanced budget, broadly defined, requires that sustainable and sizeable domestic primary balance (DPB) surpluses are generated to both fund current debt service obligations and to pare down the domestic debt stock. An important prerequisite is the development of culture of internalised fiscal discipline. The record, however, indicates that the DPB has been deteriorating, reaching a most alarming stage — a significant deficit — by the third quarter of 1999. This development is threatening to persist in fiscal year 2000 and beyond.

The destabilising path of the DPB is in spite of the fact that domestic revenues have kept pace with nominal GDP. If anything, domestic tax revenues have grown faster than GDP. Domestic non-debt expenditures have simply risen faster still — increasing at a pace that cannot be accommodated by the growth in national income. This development thus raises important issues about the efficiency, composition, and priorities of the government's expenditure programme that need to be carefully examined and addressed in a timely fashion. It also calls for a re-examination of our domestic resource mobilisation efforts.

On the revenue front, there is a need to examine the structure and incidence of taxation and to strengthen the revenue collecting agencies including through the provision of enhanced incentives and improved conditions of service. In this regard it would be preferable to retain the simplicity of the VAT. There are efficiency gains in maintaining the single rate at 10 percent. Exemptions policy may have to be scrutinised with a view to eliminating any loopholes and opportunities of abuse. The potential of the VAT needs to be more fully tapped by taking a

critical look at the registration threshold currently pegged at ₵200 million. The objective is to reduce the avenues for smuggling and relatedly the share of the domestic market in which goods that have escaped CEPS can be traded free of detection. Such restructuring of the VAT should help make it enhance the revenue collection capabilities of CEPS. This is what CEPA has referred to elsewhere as “bringing the VAT to the service of CEPS”.

No less importantly and, perhaps, even more critically, the entire expenditure envelope must be opened up for wider debate and scrutiny. In the process, greater efforts must be made to eliminate waste and unproductive public expenditures through re-prioritisation, re-phasing and proper sequencing. Increasing the productivity of government expenditure can yield high returns by way of budgetary savings, reduced negative externalities, as well as increased direct benefits.

Quite often, unproductive expenditures are the result of ambiguity and multiplicity of outputs and objectives. While secondary objectives may be important, a good working principle is to aim at the cost-effective fulfilment of the primary objective. This may lead to the realisation of cost savings which may be more than adequate for the achievement of secondary objectives in the same cost-effective way.

Key technical relationships need to be closely examined together with the economics. For example, a shortage of nurses or medicine relative to doctors which made the headlines recently is a pointer to inefficient health expenditures. Similarly, a shortage of school textbooks relative to teachers is indicative of an inefficient education system. And roads without adequate provision for operations and maintenance point to inefficient infrastructure expenditure with consequences that are well-known from the 1970s and early 1980s of Ghana’s economic history. The essence of the divestiture programme was to move into the private sector those public sector activities that could be implemented more efficiently by the private sector in a competitive environment as a means of freeing resources for those activities which only government can efficiently perform rather than as a means of raising resources for government operations.

It is important to note, as underlined above, the importance of competition in ensuring private sector efficiency. This has been confirmed in empirical studies on ownership and

efficiency. Unwarranted simplifications must be avoided in this delicate but necessary task. In some cases, an inappropriate output mix can be identified — high-technology urban hospitals in the absence of rural clinics or the World Bank often-quoted finding of high levels of expenditure on university education in the presence of increasing illiteracy rates. In many cases, however, the benefits associated with government expenditures can be neither quantified nor compared. Value judgements are, therefore, consequently unavoidable, and the domestic political process must inevitably play a paramount role. This underlies the widely-expressed concern about the bulging of expenditures in election years as seen in 1992 and repeated in 1996 and which must be strenuously resisted in this election year 2000.

Present conditions and the consequences of the adverse terms of trade shocks provide absolutely no room for over-spending in election year 2000. The point to emphasise is that, to be successful, the political process that determines the mix of government expenditures should be supported by a clear and careful economic analysis of the available policy options and their implications. The task involves not only clarity of the benefits expected to result from any specific expenditure. The possible trade-offs of benefits that may result from the reallocation of a certain amount of spending between a development project, a social programme and reduction of the deficit must also be properly clarified and openly discussed.

The aggregate resource constraint the country faces currently — substantial financing gaps in the context of an already dwindling aid pipeline, adverse terms of trade shocks on government revenues on account of cocoa and potentially on petroleum products to moderate price increases — calls for a reduction in the levels of government spending. Efficient and sustainable expenditure adjustment will likely require differential reductions in different expenditure categories rather than a simple across the board cut.

The payments arrears problem needs to be forcefully tackled. A suggested approach is to transparently declare the size of the outstanding stock through a proper audit and then formalise it so that it becomes part of the formal domestic debt. It is only when this is done that the recommendation of the last Consultative Group Meeting to set up an Internal Debt Relief Fund becomes meaningful. Clearly, the need for policy consensus and decisiveness, and the political

will needed to effect its implementation has never been more pressing.

Monetary policy must be made to work in tandem with other aspects of macroeconomic policy-making. While monetary accommodation of fiscal intransigence must not be tolerated, monetary policy must not be aimed at only the achievement of financial targets which bear no relation to the development and growth of real sector activity.

Aid dependence and delayed disbursements lead to instability. It is not helpful to have sudden and large nominal depreciations in one year to be followed by a reversion to using the exchange rate as an anchor against inflation. The evidence suggests that it is the maintenance of a stable real exchange rate that creates the relevant incentives for the traded goods sector. Such an economy cannot afford an overvalued exchange rate for a long period. Smoothing over the medium-term would appear a more appropriate strategy and management framework for such an economy. Generating the relevant social and political discipline to follow such a strategy would appear the bane of sustainable growth and development in Ghana.

2. REVIEW OF THE AGRICULTURAL SECTOR

2.1 Rainfall Distribution

The critical role of natural rains on agricultural performance in Ghana hardly needs emphasising. In deed in our field surveys of September 1999, when farmers were asked the basis of their assessment of potential production for the year, an overwhelming 66 percent named rainfall. 27 percent of respondent farmers based their assessments on their crop stands and the rest attributed their potential harvests to a combination of rainfall, crop stands, initial harvests and inputs used.

Ghanaian agricultural production is heavily dependent on natural rains. When there is a drought, famines can result. When rainfall is favourable, production responds favourably. It was in recognition of this central role that natural precipitation plays on agricultural outcomes that CEPA wrote in the Mid-year report of 1998, that:

Given that 1997 was an *El Nino* year, it was feared that 1998 might experience *La Nina*, the effects of a colder mid-Pacific surface water that can have effects opposite to those of *El Nino*. In a *La Nina* year, there are often likely to be rains, but where severe drought characterises *El Nino*, the *reverse can sometimes be devastating floods. In Ghana these too can be bad for agriculture.*

CEPA's fears did come true a year later in 1999. The rainfall in 1999 was quite severe, and led to the flooding of many low-lying, particularly, valley bottom lands of areas under 500 feet above sea level (See Map A.1). The analysis that follows is based on agro-climatic zones of the country namely: a) the Sahel & Guinea Savannah Belt, b) Transition Belt, c) the Forest Belt, and d) the Coastal Shrub and Grassland Belt.

2.1.1 The Guinea Savannah Belt

This is the area north of the transversing Black Volta. The towns here with reliable meteorological readings are Wa in the Upper West, Navrongo in the Upper East, and Tamale in the Northern Region. Table 2.1 shows the levels of precipitation in these places for the first three quarters. The mean precipitation for the first half year was higher in 1999 than in 1998. At 391mm, the Belt mean for the first half of 1999 also exceeded the Long-Term Mean Average

(LTA) precipitation (340mm).

	30 Year LTA ¹	1998		1999	
Wa	372	230		517	
Navrongo	297	292		261	
Tamale	350	387		396	
Belt Mean	340	303		391	
	30 Year LTA ²	Jul-99	Aug-99	Sep-99	Mean
Wa	193	151	193	353	232
Navrongo	220	313	405	258	325
Tamale	217	396	200	227	274
Belt Mean	210	287	266	279	277

Source: Survey (Meteorological Services Department, Accra)
 1. First Half Year 2. Per Month

The area covered by this Belt typically experiences a uni-modal rainfall pattern each year with the peak in the third quarter. The levels of precipitation for individual months over the key third quarter, with the exception of Wa in the month of July, exceeded the corresponding long-term average. Each area within the belt recorded at least one calendar month during which precipitation was more than 70 percent above the long-term average. For Wa, precipitation in September was 83 percent higher. At Navrongo, August rain was 84 percent higher and at Tamale, July precipitation was 83 percent higher than the LTA.

These high rainfall patterns resulted in floods. The Volta lake stretches up north for over 180 km to Yapei which is approximately 42km from Tamale. Feeding into the Lake are several rivers and rivulets. The low lying valleys on either side of these tributaries of the White and Black Volta rivers all became flooded, stretching from the traversing Black Volta northwards to the Builsa District to the west and south-west of Navrongo (See Map A.1).

In 1999, even the oft-flooded 'Overseas' area¹ fell victim to the worst flood in recent

memory. To the east of Tamale, the Daka and Oti rivers are the main tributaries that flow into the Volta. Both swelled. For eight weeks between September and November, large areas of the Zabzugu Tatale and Saboba-Chereponi Districts, in the eastern parts of the Belt could be reached only by air or canoe. This was moreover, the period of the yam harvest. Consequently, farmers were left stranded with large stocks of perishable produce given the limited export possibilities to Togo across the border.

Independent assessments — on residents, livestock, washed-off produce and farm incomes — are not available but MoFA figures point to a loss in production of about 10 percent of projected output. This excludes the losses on account of an earlier disaster that struck the three northern regions in June and July namely the Armyworm invasion.

The armyworm menace came about because a spell of uncharacteristically hot weather followed the first rains in April and May. Because of the increasing degree of unpredictability of the rains over the last four years, farmers had been quick to cultivate their lands soon after the first rains. As a result by the time of that hot spell, many farmlands were covered with a promising blanket of healthy foliage. The armyworm is a larval stage, which feeds voraciously on fresh foliage and internal tissues of monocotyledonous plants. One swarm of worms can normally spread over eight to ten thousand square metres at a density of up to 400 worms per square metre of land. They can, on the move, eat up completely, all the succulent leaves of maize and other grassy crops. Early warning traps, which give indications when population densities build up beyond a threshold, and spraying with chemical pesticides once the thresholds have been exceeded have been the traditional means of coping with this scourge.

The 1999 outbreak of armyworms was sudden and severe. In the Upper East region all seven Districts were affected. In the Northern region, six out of thirteen Districts were affected. Official estimates point to a loss in annual cereal production in the Sahel and Guinea Savannah agroclimatic Belt of up to 5 percent.

¹This is a low-lying stretch of land about 80km indiameter lying to the West of West Mamprusi with a proliferation of rivulets that is often flooded and cut-off from the rest of the District including the capital.

The full implications of the twin disasters of armyworm invasion and flooding are still not clear. In the area of food crop production, a CEPA field survey conducted in September showed that 70 percent of sampled farmers in the Belt felt 1999 would be a poorer agricultural year than 1998, 20 percent felt it would be a better year while 8 percent felt there will be no difference between the food crop production in 1999 as compared to 1998. The survey results also show that for farmers who cultivated rice not too close to the riverbeds, and who sowed well before the floods, 1999 turned out to be a rather successful crop year.

Outside arables, farmers in the belt also cultivate cash crops such as cotton (mostly small-scale producers) and rice (largely medium to large-scale producers with holdings in excess of 10 hectares). Over half of the cash crop farmers interviewed felt 1999 would be a better year than 1998. Most of these based their conclusions on the fact that their rice fields were well covered with water leading to expectations of lower weeding costs and the potential for a good harvest. The extensive bush fires reported in November, however, need to be duly taken into account in assessment of final outcomes.

2.1.2 The Transition Belt

The Wenchi observation point of the Meteorological Services Department is the main source of rainfall data for the Transition Belt. Available first half-year data shows that in recent years the Transition Belt has suffered very severe dry conditions. Indeed, with a mean precipitation of 207mm in 1997 and 136mm in 1998, total precipitation for these two consecutive years (343mm) amounted to only 57 percent of the long-term annual average precipitation of the Belt (599mm). In 1999, there was a sharp reversal in fortunes as the area experienced 686mm precipitation in the first six months, 15 percent in excess of the LTA precipitation and fivefold the rainfall recorded for 1998. Farmer responses in the CEPA survey not surprisingly reflected a favourable outlook.

In arable crop production, 75 percent of respondents expected their output to exceed 1998 levels with less than 10 percent predicting the contrary. In the area of cash crops including

cashew and rice, however expectations were rather pessimistic — 90 percent responses of farmers contacted indicated a poorer outcome than that obtained in 1998. There was hardly any incidence of armyworms reported in the Transition Belt. Less than 10 percent of the farmers reported any such an incidence. However, the effect of the floods upstream was felt even in the Transition Belt particularly in the eastern parts. The National Disaster Management Organisation (NADMO) reported that the important legume, cereal and tuber producing areas of Worawora, Kete Krachi and Nkwanta all suffered flood damage with an estimated 7,500 hectares of cropped fields submerged.

Table 2.2: Rainfall Distribution in Selected Centres as at June

	30 Year LTA	1983	1997	1998	1999
Sahel & Guinea Savannah Belt					
Wa	372	287	616	230	517
Navrongo	297	258	392	292	261
Tamale	350	299	644	387	396
Transition Belt					
Wenchi	599	116	207	136	686
Forest Belt					
Sunyani	610	587	491	436	644
Kumasi	736	578	989	752	734
Koforidua	481	463	656	628	872
Ho	716	465	667	589	853
Coastal Shrub & Grassland Belt					
Takoradi	741	319	717	402	657
Accra	539	244	845	250	492
Tema	482	283	1,013	222	400

Source : Meteorological Services Department, Accra

As was the case between the Zabzugu District, the Saboba District and the “Overseas” areas, here too on the Upper fringes to the east of the Transition Belt, access was badly affected

by floods. The Afram plains, another important source of farm produce was cut-off for long periods by the floods.

2.1.3 The Forest Belt

In the first six months of 1999, the Forest Belt recorded the highest levels of precipitation of all the other agroclimatic Belts. Consequently, nearly 60 percent of farmers expected 1999 outcomes to be better than those for 1998. A comparatively much lower 20 percent of responses were less sanguine.

In the area of cash crops production which includes cocoa, almost 70 percent of respondents felt that their harvest would be poorer. The remaining 30 percent of respondents expected their levels of production to remain unchanged from those of the previous year with none projecting an improvement.

2.1.4 The Coastal Shrub and Grassland Belt

This is an area where fishing and tree-crops such as palms and coconuts rather than arable crops predominate the agricultural production landscape. Rainfall has always been low and over the previous two years, cereal production in particular, has been adversely affected. In 1999, precipitation at all observation points (Takoradi, Accra and Tema) was higher than recorded in 1998 reaching close to the long-term respective averages. Farmers indicated good prospects in survey responses. They expected their cereal, groundnuts and cassava output to exceed 1998 levels by considerable margins.

2.2 Institutional Setting - ASIP and AgSIP

It would appear that to address this issue of institutional ineffectiveness, the Agricultural Sector Support Investment Programme (AgSSIP) puts great store on decentralisation and increased participation at the district level. There appears to be considerable confusion in public discussions of the AgSSIP with the earlier Agricultural Sector Investment Project (ASIP).

The Agricultural Sector Investment Project (ASIP)

The ASIP was sponsored by the World Bank. The MoFA sought through it to provide:

- a) financial support to producers associations and their support organs such as local authorities;
- b) technical support to these groups by way of the development and design of their identified project need, and their implementation; and,
- c) skills training on effective management of projects to these same groups.

Thus, MoFA hoped to expand agricultural investments, eliminate some of the key constraints to agricultural production and productivity in rural areas and thereby to improve improving rural incomes and alleviate poverty.

To run the programme successfully, MoFA was to identify and establish Technical Support Agencies (TSAs) that would work with the target producer groups to design, construct, operate and maintain infrastructural and other requirements where necessary. Some of the project types considered eligible for ASIP support included the construction of new or rehabilitation of existing a) water sources for agricultural use; b) market sites; c) access roads into high food producing areas; and, d) village and farm level arable produce storage and processing units.

To ensure commitment and sustainability, the strategy laid down mandatory beneficiary cash contributions by the target group. This ranged from 10 percent of project costs for small-scale water projects to 25 percent for physical infrastructure projects. Production groups were also expected to have a minimum of 10 members and to demonstrate by documentation (i.e. association by-laws, records of meetings, list of membership contributions etc) that they were a well-established group.

ASIP spanned between 1994 to 1998 and it included the strategies required to resuscitate the flailing rural economy. It held the potential to induce producer group formation, promising beneficiary involvement from project initiation to full implementation, and with the expectation that by the end of an initial period (about five years) the target group could survive on its own without further assistance. All the usual prescriptions in the literature deemed necessary for the growth of rural economies appeared to have been addressed in this strategy.

The AgSSIP

The AgSSIP is the latest of the government initiatives to move agricultural sector growth to higher levels. It was set up as the main instrument for implementing the Accelerated Agricultural Growth Strategy (AAGS) that was itself formulated to enable Ghana achieve the status of “a prosperous middle income country by the year 2020”, and to which end five major elements of policy, institutional and investment reforms have been identified for action. These are:

- improving access to markets and promoting the production and export of selected commodities;
- facilitating access to agricultural technology;
- facilitating and increasing access to rural finance; and,
- Providing rural infrastructure.

MoFA identifies that currently the government finances agricultural development by discrete projects. This leads to such drawbacks as:

- wastage from poor co-ordination and therefore duplication and fragmentation of aid management that strain human and financial resources;
- inflexibility in allocation of resources emanating from weak public expenditure management particularly in counterpart funds ; and
- programmes dictated by donor agenda rather than government prioritisation.²

As quoted by MoFA, “the AgSSIP Concept derives from what is known as the Sector Investment Programme approach in which a national integrated programme of a country’s expenditures in a given sector is financed by government and a consortium of donors who are committed to pool their resources to implement a sector-wide programme.”

The strategy identifies a decentralised institutional structure as essential. Such decentralisation should also serve as a positive step towards eliminating multiple (often

² A question that comes to mind is why donor interest should differ from government plans. Is it a reflection of poor public sector prioritisation of it's interest?

overlapping) project units, a situation that easily arises where two donors, each independently funds a common cause, in their own respective ways. It is also hoped that this way, the potential exists to build up long term planning, design and implementation management capacity in the country.

AgSSIP has been long in the incubation stage to ensure what in official circles is described as a 'Wide Stakeholder Participation'. Thus as far back as early 1995, MoFA entered into consultation with stakeholders. This culminated in the Agricultural Development Forum organised by MoFA at Cape Coast in September 1995. AgSSIP is expected to be in place by 2000.

It is the expectation of MoFA that a 'supportive government policy environment like AgSSIP, should enable...farmers who have been operating in a distorted policy environment', and under 'inefficient provision of financial, inputs and market services...to function more effectively'³. Consequently, agricultural GDP is projected to more than treble the 1996 estimate of US\$2.9 billion in the next few years.

2.3 Infrastructural Setting

Whereas infrastructure such as roads, market buildings, bridges and silos are necessary for agricultural development in Ghana, strong institutional frameworks in the legal and financial sectors as well as environmental policies could provide further boost for its development.

High marketing costs are typical of countries in the early stages of structural transformation. These include:

- costs of overcoming lumpiness of initial investments in production, processing, and marketing;
- spoilage of higher value agricultural products (especially livestock, poultry and horticultural produce);
- costs due to wide differences in quality as a result of non standardised processing standards;

³ MoFA (1998) Ghana's Agriculture: transition from Policy to Implementation p. 16.

- costs of inflexibility and lags in production plans imposed by an over-dependence on the harvest of natural resources (e.g. rain water);
- costs of dealing with the seasonal variability in output in thin markets with poor storage and bulk breaking facilities;
- search costs that include the high opportunity costs of time and lack of knowledge of which markets would have offered better returns;
- information asymmetry leads to high costs of screening trade partners;
- bargaining costs;
- monitoring costs;
- costs of contract enforcement; and
- locational and temporal costs such as transport, handling, packaging, and retail transfers.

The Technoserve inventory credit scheme in which a group of farmers are provided credit against their inventory of produce and advised on the timing of sales to optimise their incomes seems to have resolved an age-old dilemma in Ghanaian agriculture — farmers losing output in times of adverse weather, and suffering losses in income in times of good weather. In the Technoserve concept, research into price trends in the cereals trade is used as the basis for advising farmer groups and individuals on grain inventory management. This way, realisable gains are made by maize producers from selling at strategic times. The granting of credit obviates the necessity to sell in the immediate post-harvest period which creates a supply glut and sharp falls in market prices to the detriment of farmers. At the same time the inventory of produce serves as collateral which reduces the risk of the lending institutions.

For banking services to be useful in facilitating accelerated growth of the agricultural sector, it must have the desirable features of a wider outreach and sustainability. At present, rural banks have addressed some of the needs of the rural sector. Their patronage and influence, though, is still very limited. What will make them the prime-mover factor that they ought to be is an empirical issue.

Sustainability is linked to the combination of savings mobilisation and interest rates charged for credit. In commentaries on agricultural credit in Ghana, savings mobilisation has not

attracted due attention. Most discussions on intervention focus on whether or not to subsidise, and thus institutional lenders do not seem to have made aggressive attempts to encourage farmers to save. Admittedly, the issue of determining the interest rate for agricultural loans is critical and entails trade-offs especially for a government. On one hand, the government wants to encourage lenders to finance farming activities whilst on the other, it is under pressure to set low interest rates for agricultural loans as an incentive.

Unfortunately, the policy of low interest rates often sends the wrong signals to the financial sector. The reason is that while interest rates are held below market rates, the cost of administering and supervising the forms of small deposit accounts scattered among widely dispersed individuals is very high. The reaction from lenders is therefore to reduce their loans to small-holders, raise bank charges, or increase the minimum amount of deposits.

CEPA fieldwork responses from farmers indicate that interest rates are not the main issue to farmers instead the speed with which the loans are processed. Respondents were concerned about the risks of their production environment and expressed their desire to minimise those risks. One way by which that risk factor could be reduced is through the provision of water. Support to a viable irrigated agricultural system that exploits technologies such as tubewell systems which are not technically and financially beyond the farmers would support a sustainable improvement in production. The minimisation of output variability associated with irrigation can facilitate easier assessment of risk adjusted returns and provide an opportunity for close co-operation between neighbouring farmers. Irrigated agriculture will also assist producers to diversify their agricultural enterprises in response to changes in market demand.

3. REVIEW OF THE INDUSTRIAL SECTOR

3.0 Introduction

The conduct of macroeconomic policy—fiscal and monetary, including exchange rate policy— in 1999, has led to a poorer economic out-turn than anticipated. Continued deterioration in the fiscal balance, the reliance on liquidity management that apparently focuses almost exclusively on the attainment of financial targets, the continued mis-alignment in the exchange rate, at least up till the half year, and the correction that occurred in the second half of the year, have all contributed to the generally weak performance in the industrial sector of the economy, as is evidenced by performance, especially in the strategic sub-sectors surveyed by CEPA.

The situation was made worse by the adverse terms of trade shock that the economy experienced from the second half of 1999, the effects of which may be even more pronounced in 2000. The effects of these inconsistent policies are generally reflected in higher real costs of borrowing, a highly appreciated real exchange rate leading to an expectation of a large depreciation, and generally an uncertain environment for business decision making —on investments either local or foreign.

Given the current low levels of domestic savings (in part, the result of a weak and fragile financial intermediation system) and hence low levels of investments, extreme aid dependence and high external indebtedness, the need to augment our investments through foreign sources, particularly Foreign Direct Investment (FDI) becomes even more imperative. The available evidence, however, shows that FDI inflows are dwindling. Data obtained from the Ghana Investment Promotion Centre (GIPC) show that **actual** FDI inflows declined by sixty percent (60%), from US\$67.8 million in 1997 to only US\$26.7 million 1999.

Additionally it is important to note that, Ghana's key industrial sub-sectors are highly import intensive —an average of 45 percent dependence on imported inputs for production. Large discrete changes in the exchange rate, are therefore likely to impact adversely on their production costs, output and employment and thus, compromise the nation's growth and employment objectives.

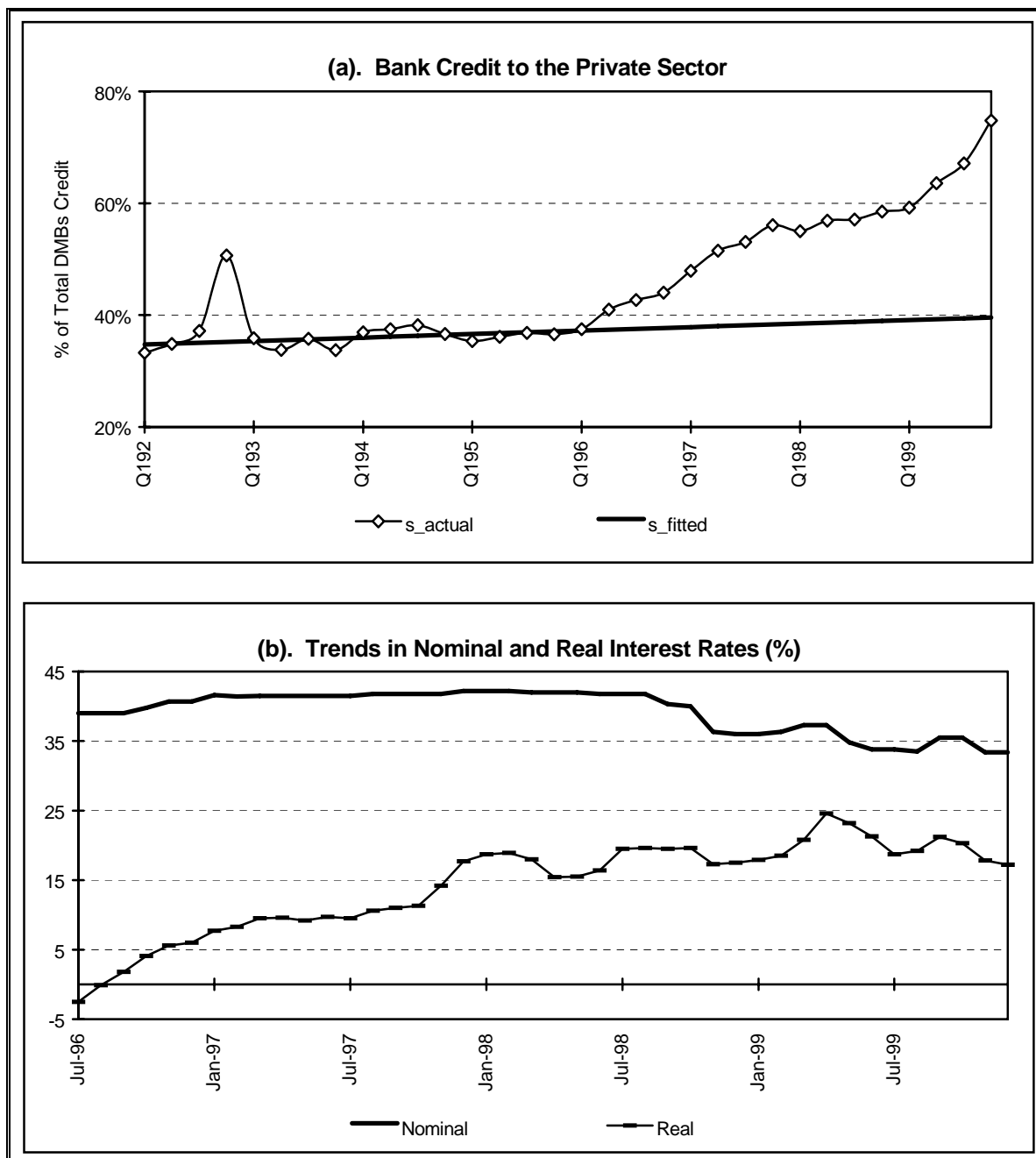
Given the unique Ghanaian experience of 1998—the "power shock"—and the positive response by both government and the private sector—CEPA was optimistic that a more stable macroeconomic environment supported by a more stable supply of power would result in higher levels of production in the key sectors of industry than prevailed in 1998. In fact, in its *Ghana Macroeconomic Review and Programme 1999*, CEPA had projected that electricity output for the first half-year of 1999, would at least stabilize at the levels prevailing in the second half of 1998. Consequently, capacity utilization and production levels in the key sectors of Industry (Steel Products, Mining, Food and Beverages) were likely to be higher, than the comparable period for 1998 (especially given the critical role of power in the production processes). While the assumptions on power production were generally realized, the requisite macroeconomic environment did not materialize.

On the one hand, while trends in financial indicators—growth in credit to the private sector, declining nominal rates of interest (the result of declining rates of inflation)—would point to a booming economy, indicators in the real sector—real interest rates, trends in enterprise failures and employment—on the other hand, point to a weak and fragile productive base for the Ghanaian economy. Even then, the apparent positive indicators in the financial sector must be interpreted with caution. As was most aptly demonstrated by the East Asian crisis, high growth rates in credit to the private sector, more often than not, are critical indicators of an economy that is highly indebted, very fragile and on the verge of collapsing.

In the Ghanaian example, a disproportionate share of the rising credit to the private sector, represents "proxy" borrowing by the sector to accommodate the large stock of government arrears and not funds directed at augmenting the stock of capital. As is shown in Figure 3.1a, since about the third quarter of 1995, the share of bank credit to the private sector would appear to have grown rather sharply from about 35 percent to 75 percent by the end of the third quarter of 1999. However, after adjusting for the arrears, the apparent high

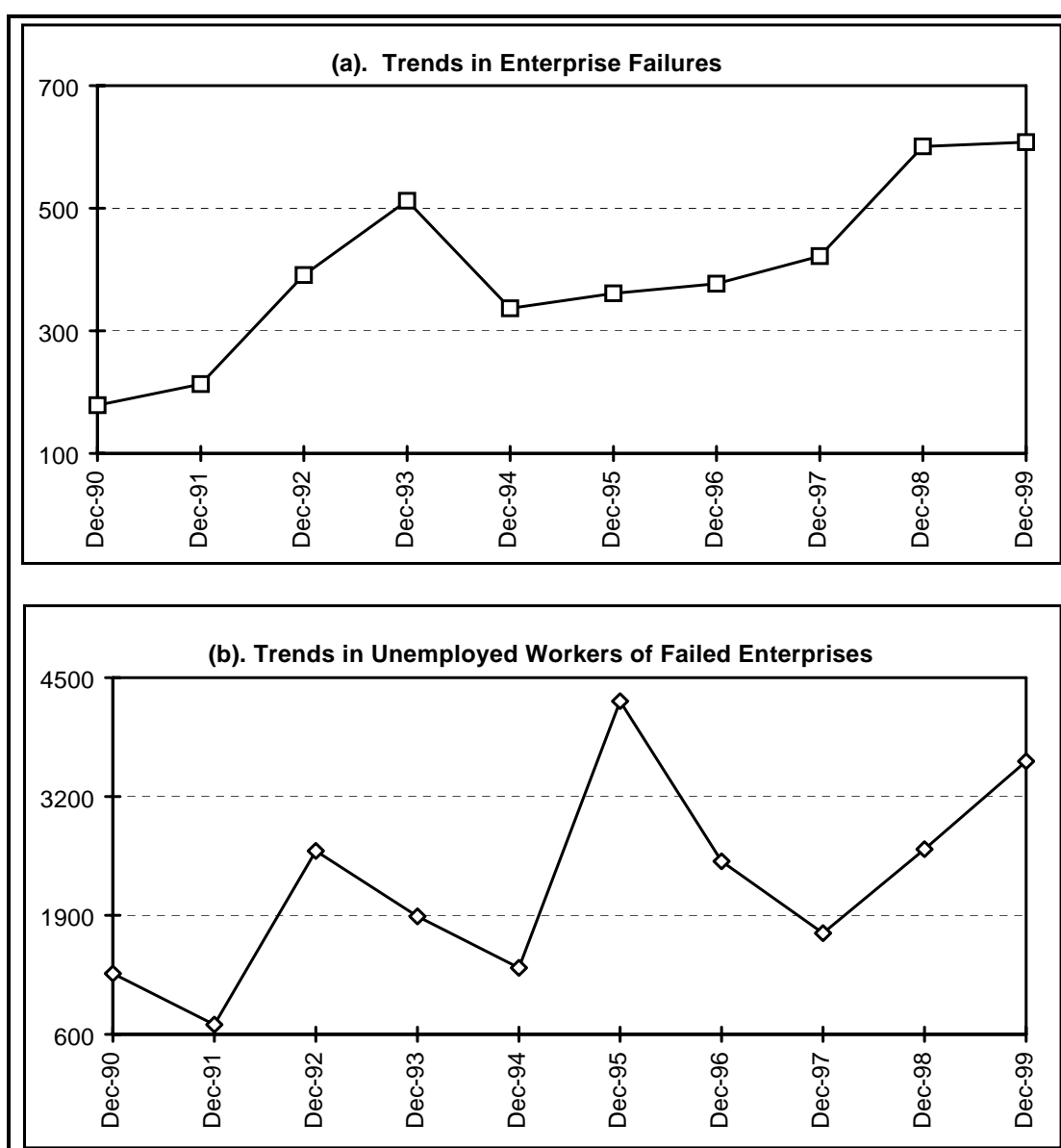
growth is considerably dampened, with the share rising to less than 40 percent. Thus, as a source of funds for investment purposes, credit to the private sector has only increased by a little over 1

percent per annum, since 1995.



Moreover, the real cost of capital—the bank lending rate adjusted for inflation—the relevant variable for investment decision making, has remained burdensome, at an average of

over 20% throughout 1999. Since September 1996, real lending rates, have remained positive and on an upward trend (see Figure 3.1b). For a nation with a growth rate of real income which is on the average about three to five percent, such high lending rates, if sustained, do bias investment decisions away from lower return, longer-term, more productive activities towards shorter, higher returns, more speculative ones.



Additionally, the cedi experienced a sharp depreciation of about 38 percent against the dollar between the end of the second quarter and the end of the fourth quarter. It must, however,

be noted that for the first three quarters of 1999, the inter-bank forex market ceased to function in any meaningful way. As later developments revealed, transactions in dollar prices were much higher than the indicative exchange rates used by the BOG for the computation of the official exchange rates.

These developments—high and rising real rates of interest together with a sharply depreciated cedi—in the short-term, tend to increase the domestic costs of production, with a consequent loss in the competitiveness of domestic producers. Over time, the rate of enterprise failures begins to rise with its attendant adverse implications for employment and growth (see Table 3.1 and Figures 3.2 and Box 3a).

On the contrary, the preliminary evidence available, suggests that power supply in the first half-year of 1999, has been much better than anticipated, largely the result of larger transmission from Akosombo, as well as guaranteed supplies (100-200 MW) from the Ivory Coast to ease peak level demand. As a result of the better than anticipated supplies from Akosombo and Kpong, the Takoradi plant has become a contingent power producer. Power supplies from Takoradi have been limited to about 110 MW—just a third of 330 MW current capacity. This policy has been reinforced by the rising cost of petroleum in the course of the year. Between January 1 and November 30 of 1999, petroleum prices rose by 135 percent in dollar terms.

The effects of a more stable power supply and other economic developments, national and international, are examined below for the leading sub-sectors of the industrial sector, namely, mining, steel, beverages and cement. This is to provide a preliminary assessment of economic performance in 1999 as compared to 1998. An analysis of the evidence points to a wide variability in performance among sectors.

Table 3.1: Enterprise Failures By Region

REGION	1996	1997	1998	1999
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GREATER ACCRA	180	124	298	291
ASHANTI	41	51	54	70
WESTERN	33	24	28	30
EASTERN	35	17	27	31
VOLTA	21	28	14	17
UPPER EAST	21	48	23	21
UPPER WEST	1	37	37	14
CENTRAL	26	57	48	70
BRONG-AHAFO	17	25	30	35
NORTHERN	2	11	42	29
TOTAL	377	422	601	608

Source: A survey of Industries conducted by CEPA

Box 3a: Trends in Enterprise Failures and Employment

There is increasing evidence that the loss in competitiveness of Ghanaian enterprises has led to an increase in the number of failed enterprises, especially in recent years. Preliminary analysis of available data shows that since 1995, an average of over four hundred and seventy (470) enterprises per year have closed down. Between 1995 and 1999, the rate of enterprise failures increased by over eighty (80) percent. The largest yearly increase (42%) occurred in 1998, when the nation experienced the "power shock".

When examined from a regional basis, the Greater Accra Region tends to have a disproportionate share in the number of failed enterprises nationwide. Except for 1997 when its share dropped from 29%, it has maintained a share of about 48% in recent years. Ashanti Region has the second worst, but stable share of twelve percent (12%). Four regions (Eastern, Western, Volta and Upper East) have improved their rankings by recording declining shares over time. On the contrary, the remaining four regions (Upper West, Central, Brong-Ahafo and Northern) experienced the sharpest rises in the rate of enterprise failures. Not surprisingly, these regions are also the ones where poverty is most pervasive and agricultural activities dominate economic activity. These trends in enterprise failures are consistent with a recent Association of Ghana Industries (AGI) report which concluded that membership declined from one thousand five hundred (1500) to five hundred (500), with an active membership of only two hundred and fifty (250).

As would be expected, the closure of enterprises has led to the displacement of workers. Since 1995, an average of over two thousand and seven (2007) employees per annum have lost their jobs directly as a result of the enterprise failures noted above. Even though the number of displaced workers has declined over time to about one thousand seven hundred (1700) workers in 1997, the last two years have seen sharp reversals. The growth rate in the number of displaced workers from closed enterprises increased by fifty four percent (54%) in 1998 and a further thirty seven percent (37%) in 1999. A 1996 UNIDO report on the Textile Industry confirms these trends. In that report it was estimated that employment in the industry dropped sharply from about twenty five thousand (25000) in 1975 to about seven thousand (7000) in 1995.

Even when note is taken of the weaknesses and the inconsistencies generally associated with data on enterprise failures in Ghana, casual empiricism and anecdotal evidence would point to the urgent need in re-examining how overall macroeconomic policies get transmitted through to micro units in the economy, especially enterprises, and the extent to which such policies may promote enterprise growth and employment.

3.1 Developments in the Mining Sector

Table 3.2 presents production/sales data for enterprises in gold-mining. It groups producers into three categories:

- large, i.e., annual production of at least 40,000 ounces
- medium, i.e., annual production of least 500 ounces but less than 40,000 ounces and
- small-scale generally grouped under the Precious Minerals Marketing Company (PMMC).

It is interesting to note that AGC (Ghana) has about 60 percent of the market share of the large producers and about 50 percent of overall production in Ghana.

	January- June 1998		January- June 1999		Growth (1999/98)	
	Volume	Value (US\$ m)	Volume	Value (US\$ m)	Volume	Value
Gold (000's of ounces)	1,053.90	325.05	1,163.39	333.31	10.4%	2.5%
Large-Scale Producers	955.60	296.80	972.70	282.78	1.8%	-4.7%
Medium-Scale Producers	67.54	20.16	147.00	38.63	117.6%	91.6%
Small-Scale Producers	30.75	8.09	43.69	11.90	42.1%	47.0%
Daimond (000's carat)	410.87	8.66	354.99	6.19	-13.6%	-28.5%
Bauxite (000's of metric tons)						
Sales	204.86	4.22	172.18	3.70	-16.0%	-12.3%
Production	250.25	-	171.18	-	-31.6%	-
Manganese (000's of metric tons)						
Sales	195.88	5.86	306.90	9.74	56.7%	66.2%
Production	282.82	-	198.10	-	-30.0%	-

Source: Ghana Chamber of Mines and CEPA Staff Estimates

The data provided in Table 3.2 point to a weak performance in the gold sub-sector for the half-year 1999 when compared to the same period in 1998. Export data for the large

producers of gold show a marginal improvement in volume of less than 2 percent. With the average price realized declining by 6 percent—from US\$310 per ounce to US\$290.7 per ounce—the value of sales for this group of producers fell by 5 percent.

In contrast, producers with sales of less than 40,000 ounces, experienced a phenomenal growth in the volume of sales of over 100 percent. Thus even though the average price realized for this group of producers fell even more sharply (12 percent) than that of the former group, the value of sales rose by over 90 percent.

The performance of the small scale (galamsey) operators for half-year 1999 was robust when compared to half-year 1998. In volumes terms, there was an increase of over 40 percent in sales. This is partly attributable to better price incentives (aside from an increase in the number of operators) offered by the PMMC. In the first half of 1998, the average price realized by this group of producers was the lowest among all producers (US\$263/oz). In contrast during the half-year 1999, the average price realized had increased by about 3 percent to US\$272/oz. This was higher than the average price received by the middle group, namely those producing less 40,000 ounces (US\$263/oz) but lower than the realized price (US\$291/oz) of the large scale producers.

As a result of the improved performance of the latter two groups of producers, overall performance of the gold sub-sector rose marginally in value terms by about 3 percent, in the face of an average price decline of over 7 percent.

Developments in the other minerals sub-sectors were, however, mixed. While diamonds and bauxite showed slower growth, the manganese market in contrast, was quite robust (see Table 3.2). Sales of diamonds by volume, for the first-half year in 1999, fell sharply by 14 percent. The average realized price for the same time period declined even more sharply by about 17 percent.

In the bauxite market, the average price rose by about 4 percent, the volume of sales declined by 16 percent, while production declines were even sharper—about double the rate of decline in sales.

The stocks of inventory built up in the first half-year of 1998, remained intact in the first half-year of 1999, as production in the period equaled sales. The sharp decline in production would appear to confirm the persistence of severe transportation constraints faced by the industry.

Growth in the global demand for manganese was buoyant, with sales increasing by over 56 percent. The increase in demand, resulted in a higher realized price, about 6 percent than that of 1998. The increase in sales volume was met by a draw-down in the stocks of inventory equivalent to about 38 percent of the production levels of half-year 1998. Production during the period was lower by about 30 percent compared to the corresponding period of 1998. The persistence of the production bottlenecks, however, is likely to adversely affect the industry's ability to meet future increased demand as the stocks of inventory get exhausted.

Sales from gold exports (and by assumption production) for the period ending the third quarter in 1999, point towards an improved performance in the mining sector. On the average the volume of gold sales through the period ending September 1999, were at least 57 percent higher than for the period ending June 1999, for all categories of producers.

The value of gold sales, on the other hand, increased by about 50 percent, implying a decline in the realized price of about 4 percent. Given the marketing strategy —forward selling— of the major gold producers, however, the increase in the volume of sales is not surprising even in the face of lower realized prices. Contractual obligations will not permit lower production volumes.

Performance in the other minerals sub-sector, for the period ending in September 1999, mirrored that of the gold sub-sector, but with slightly lower increases in both volumes and values for the same time period. The economic fortune of the mining sector is largely determined by the performance of the gold sub-sector. Given the recent developments — price fluctuations in the international gold market, layoffs in the domestic sector, especially regarding its impact on the large domestic gold producers— the mining sector's overall performance for

1999 is not likely to exceed that for 1998.

Given the lower realized average prices, it is clear that profitability will be lower. More importantly, the lagged effects of the lower prices are likely to impact more severely on production in 2000. Casual empiricism points to the folding up of some gold-mining companies, while production at AGC (Ghana) Limited, the dominant gold producer, may be severely affected by the recent events.

3.2 Developments in the Steel Sub-Sector

The domestic steel sub-sector is the largest and in recent times the fastest growing sub-sector of manufacturing in Ghana. Policy measures have been directed to assuring regular/uninterrupted power supply to this important strategic sector, including special government-supported bilateral arrangements of supply between the steel companies and independent power suppliers. There has also been a resurgence in the world demand for steel and steel products, associated partly with the recovery of economic growth in East Asia.

In spite of these favorable developments, the sub-sector continues to languish in deep problems. Labor unrest, and rising production costs—due to higher costs of power and a more depreciated currency, resulting in a higher cost of imported inputs including scrap metal—have seriously eroded the competitiveness of domestic steel producers.

Currently imports of final products are estimated to have a price advantage of between \$30-\$50 per ton. Given the high import intensity of the industry—currently estimated at about 30 percent—an average depreciation of 9 percent (as of June ending), translates directly into an additional increase in domestic production costs of about 3 percent. With the cedi depreciating further by about 25 percent, between end-June and first week of November, production costs are expected to escalate even further.

These developments, we estimate, have greatly adversely impacted on the performance of some firms for the half-year 1999. Preliminary indications point to very low capacity utilization rates and production levels for the first half-year of 1999, which are lower than those prevailing

in the comparable period for 1998— during the peak of the energy crisis. It was reported that during the energy crisis, some producers resorted to imports of finished products to sustain cash flow and to keep market shares. Field survey reports indicate that this practice has continued and the expectation is that it will continue through the year 2000.

The cause for concern is that in the absence of new initiatives the domestic steel industry is unlikely to recover from these constraints, difficulties and "competitive" pressures as, for example, implied by the anti-dumping sentiments regarding the "arguably" cheap steel exports from the former Soviet Union and its satellite states (See Box 3b).

Box 3b : “Competitive Pressures” from Inefficient Producers

The basic rules of the market economy do not yet fully apply in the former Soviet Union and her satellite states. So dozens of loss-making steel plants have been kept afloat by a “unique universe of perverse economic incentives”. Distortions include - different tax rates for different enterprises, differential law enforcement, differential access to government-controlled export infrastructure, preferential access to land and government procurement, different energy prices, variable degrees of red-tape - all of which favor less productive companies. These states are consequently saturated with cheap bad quality steel, while efficient producers have no incentives to expand. Political gridlock prevents their removal and thereby unlocking of growth. Thus, several years of “market reforms” have only made the comparative advantage of these states - states infamous for their appalling productivity and waste of resources - even worse still. Many of the enterprises using them are moreover over staffed.

Paternalism may have prevented social unrest, but such job protectionism has distorted the market for the more efficient producers. Financial success is all too often determined by how skillfully a manager may attract federal or regional subsidies or negotiate a discount on his electricity or tax bill than by selling goods efficiently. These are the producers who act as a drag on the productivity of the sector as a whole. The difference between the market and the state is disappearing. As a result, some officials consider public service as a continuation of the market and often interpret democracy as a free market for corrupt services.

Rationalizing the steel sector would be politically unpalatable given that many of these smaller steel plants sustain entire communities. It may be economically better to subsidize the retraining and relocation of redundant workers than “waste public money on keeping moribund companies alive”. Even though this strategy of developing the steel industry may have given the companies a “temporary” advantage over their counterparts in Ghana - allowing them to freely dump steel products on the Ghanaian market - it is certainly not the path to follow. A better example, the case of the Venezuelan steel industry, is discussed below (see Box 3c).

The sub-sector though, through its forward linkages, especially with the construction and basic metals sub-sectors, however, plays an important and strategic role in the Ghanaian

economy. The difficulties, therefore, need to be addressed for the longer-term interests of the country. Resorting to tariff and non-tariff barriers against imports does not represent an appropriate solution. Experiences such as those from the Venezuelan Steel Industry provide valuable insights for a possible way forward (See Box 3c).

Box 3c: The Venezuelan Experience in Steel Production

*About twenty years ago, the Venezuelan Steel Industry was faced with similar challenges and opportunities as is being experienced in Ghana. Venezuela, however, is currently the largest (with an estimated 20 percent of total global production) producer in the world of briquetted direct reduced iron (DRI) used in electric furnace steel-making. It may be argued that the nation's rich endowment of iron ore, natural gas, and hydro-electric power made this growth strategy possible, but it is also unlikely that Venezuela would have pursued it were the nation to have abundant reserves of the high-quality metallurgical carbons used in conventional steel-making. This selective factor disadvantage, as it were, was **decisive** in the decision by the industry to upgrade by developing the competitive advantage via technological innovation.*

The world market for DRI has been strong and growing. The U.S. steel industry has been shifting towards mini-mills, which rely heavily on scrap metal and DRI. Currently, global supplies of high-quality scrap are under severe pressure. Moreover, the mini-mills sector has moved into producing the best quality steel, which in turn requires DRI technology. There is increased global demand for high-quality steel as a result of reconstruction in Europe and the on-going recovery in Asia. There are important lessons to be learned by the Ghanaian steel producers.

These trends present both challenges and opportunities for the Ghanaian steel industry. The challenge in going forward, is not to seek to recoup sunk costs but rather to ensure that in the future, Ghanaian steel industry will adopt more cost effective methods of production, learning, and especially innovation. Government support and assistance will even be more important during this unavoidable restructuring period. (The point may also be made that "cheap" power gave Ghana a comparative in the sub-region. While this may have been lost, labor may have been trained and traditions of working models strengthened which Ghana should not give up lightly).

3.3 Developments in the Beverages Sub-Sector

The recent structural changes (mergers and acquisitions) that have taken place, particularly in the alcoholic beverages sub-sector, have brought about both qualitative and quantitative improvements in the productive capacity of the sub-sector. Modernization of plant and equipment, expansion in capacity, improvements in brewing techniques resulting from the

transfer of technology from parent companies, better management practices and productivity increases, have all contributed to the observed increases in economic growth in the sub-sector.

The average growth in gross turnover for the major breweries in the first half-year of 1999 is estimated at about 34 percent over that of the comparable period of 1998. When note is taken of the fact that price increases for the period in question were minimal, it becomes apparent that the observed increase in turnover reflects purely a rise in the volume of production. This performance has important implications for tax policy, especially when account is taken of the fact that the highest increase in turnover occurred in the higher priced segments of the sub-sector. More specifically, this would suggest that moving from an ad-valorem tax to a specific tax, if the observed trends in sales should continue, would yield even more revenues for government (on the assumption that spare capacity exists).

In spite of the robust performance in the beverages sub-sector for the first half-year, indications are that performance in the second half-year is not expected to improve dramatically over that for the first half-period. Even though, production volumes are likely to stabilize, the impact of the developments in the exchange rate on profitability, especially in the last quarter of 1999, has been severe.

Aside from the significant increases in the costs of imported inputs (implied by the large depreciation) access to foreign exchange is increasingly becoming more difficult as is evidenced by longer queues in the inter-bank foreign exchange market. In addition to the higher costs of and lower access to foreign exchange that establishments are experiencing, firms are also reporting large losses in the foreign currency values of the stock of their assets—also a direct effect of the more depreciated cedi.

The policy implications of such developments are obvious. Unless the exchange rate is managed properly, the future investment decisions of these branches of multi-national corporations could be severely impaired, especially when compared to their counterparts operating in other countries. As their profitability and net worth in foreign currency terms get eroded by a fast falling cedi, they become less attractive assets in the portfolios of their

respective parent companies. It is important to note that these developments have also affected similar firms in the food sub-sector, especially Nestle and Unilever. The recent announcement by Unilever International to reduce the number of employees in USA and Europe by 25,000 should thus be taken seriously for the potential implications for Unilever Ghana.

Ghana is a low savings country. In the short to medium term, foreign savings and hence foreign investments are critical for our growth, employment and poverty reduction objectives as envisioned in Vision 2020. Thus, a flawed exchange rate policy that threatens to induce potentially large losses in foreign direct investment inflows must be avoided.

3.4 Developments in the Cement Sub-Sector

The cement sub-sector has generally performed well in recent years, riding on the back of a boom in the construction—roads, commercial and residential buildings—sub-sector. With a share of about 15 percent of the total output in the manufacturing sector, its contribution is only surpassed by the contribution of the iron and steel products sub-sector. Except for a temporary drop in the capacity utilization rate, and hence loss in production that occurred during the period of the energy crisis, the average capacity utilization in the industry has exceeded 85 percent. Indeed, to accommodate an expectation of increased sales, total capacity was recently increased by over 70 percent, from 1.4 million metric tonnes to 2.4 million metric tonnes a year.

In spite of these developments, recent events are beginning to affect profitability in the sub-sector. First, during the energy crisis, significant costs were incurred to rent and operate generators. With higher power tariffs, the share of power costs in total production costs has risen from about 4 to 10 percent. These additional costs were initially absorbed through a reduction in profits, especially since sales volumes remained stable. Indeed from April 1998 to April 1999, there were no increases in product prices.

More recently, however, the adverse trends in the exchange rate have significantly added to costs and hence reduced profitability. As the industry is heavily import intensive, the fast depreciation implies a rising increase in the costs of production. As a consequence of the higher production costs and to minimize the losses in profitability, product prices have been

increased four times from April 1999 to the end of the year. Given its linkages to other important sectors of the economy, the implications for price increases in other sectors and hence higher inflationary consequences, are worrisome.

While the sub-sector has recorded impressive growth rates over the years, there is great concern about the sustainability of these rates. To the extent that the boom in the construction sector continues, then the cement industry will thrive. Current indications, however, point to a slower pace of growth in the construction sub-sector, particularly in the areas of government infrastructural development. In the short to medium term, these developments are likely to have an adverse impact on profitability in the sector, particularly if the costs elements in production, implied by a more depreciated exchange rate, cannot be contained. In the face of these developments and given the fact that the industry has been operating at or near full capacity, any decisions on capacity expansion will become increasingly difficult.

3.5 Conclusion

Ghana's current industrial policy is biased towards the development and growth of small and medium-sized enterprises. While an argument can be made in favor of this bias, because of the dynamic employment generating potential of such enterprises, the reality is that in the short to medium term, it is the larger firms, especially those affiliated with trans-national companies, who are at the center of Ghana's industrial production. These relationships over time, have allowed these firms to have access to both the technological and credit requirements of modern industrial production.

Smaller and medium scale enterprises are, on the other hand, constrained by such requirements. At their current rates of production, they are not internationally competitive, at least in the short to medium term. Industrial policy must thus aim at properly balancing the imperative to ensure the survival of these larger firms, and the need to nurturing the growth of the smaller firms for the longer term. The employment generating objective should not be confused with the internationally competitive objective.

Aside from the production of cocoa beans, where Ghana is internationally competitive

(controlling about 8 percent of total world exports), the nation is reported to be potentially internationally competitive in at least fifty products. But surely it cannot expect to promote this wide range of products successfully and also hope to become internationally competitive in all of them. One strategy that can be pursued, would be to tie the promotion and growth of the smaller and medium sized enterprises to a *carefully* selected but limited group of products, where our competitive advantages are more easily identifiable. Special opportunities have been identified in the areas of food processing, garment manufacturing and wood furniture. The thrust of this strategy is to engage in a limited number of things but to do them well.

As the earlier analysis has demonstrated unambiguously, the survival of the larger firms, however, depends critically on how well we manage the exchange rate, given that a large majority of these firms are highly import intensive. The current mis-alignment in the exchange rate, which has increased the cost of, and also reduced firms' access to, foreign exchange, will over time decrease the international competitiveness of these firms. As branches of multinational companies, they will become less attractive when compared to their sister companies operating in other countries. The potential loss of future foreign direct investment inflows resulting from such mis-alignments in the exchange rate must thus, be taken seriously.

In the longer-term, Ghana's development paradigm must begin to refocus on increasing the stock and improving the efficiency of its human capital. In the new global world where technological capacity and the ability to use such technology are the key factors for sustained growth and economic progress, Ghana is woefully lacking (see Box 3d). All available evidence suggests that countries that have successfully transformed their economies and become internationally competitive did so by significantly transforming their educational systems.

Box 3d: Importance of Education in Ghana's Development

The vision of Ghana in the year 2020 is that of a transformed economy and society that has achieved the status of middle-income country. The consensus of observers and commentators of the present day middle-income countries in Asia is the important role of education in the transformation of those economies. Education benefits the individual and society. It is important in the growth and development process because it improves the quality of the labour force, increases the ability to absorb new information, contributes to the removal of social barriers to growth, and encourages entrepreneurship.

Table A1: Comparative Enrolment Rates in Education				
	Year	Ghana	Malaysia	Thailand
<i>Per Capita GNP (US\$)</i>				
	1970	250	390	210
	1980	430	1800	720
	1990	400	2400	1530
Gross Enrolment Rates (%)				
First Level	1960	59	96	136
	1970	61	91	81
	1980	79	93	99
	1990	77	93	99
Second Level	1960	3	19	8
	1970	11	34	17
	1980	41	48	29
	1990	37	58	30
Third Level	1960	0.24	1.21	1.92
	1970	0.79	1.99	2.02
	1980	1.6	4.1	14.7
	1990	1.4	7.2	15.7

Source : UNESCO Statistical Yearbook, 1979 and 1998

Enrolment rates have increased at all the educational levels in Ghana since 1960. There was a downturn in the 1980s when enrolment rates at the first and second levels declined. A comparison of gross enrolment rates between Ghana on the one hand, and Malaysia and Thailand on the other, reveal two important facts. In 1960 when Ghana's per capita GDP was not much different from that of Thailand and Malaysia, these two countries had higher gross enrolment primary school rates than did Ghana. Almost every child between the ages of six and eleven was in school. Thirty years later in 1990, even though Ghana's gross enrolment rate for primary education has risen, it is still below the rates achieved by these countries in 1960. The successful transformation of Ghana's economy requires an improvement in enrolment rates at all the levels of education. Critical to achieving this is a commitment of resources of both private and public sector education. Incentives must be created to increase the demand for education of the household. Finally, there must be co-ordination of education policies and the economic strategy. This is to ensure that the products of the formal education institutions meet the manpower requirements of the economy.

4. REVIEW OF PUBLIC FINANCE AND FISCAL OPERATIONS

4.0 Introduction

Ghana's current economic problems, in a fundamental sense, have their origins in the lack of complementarity between fiscal and monetary policies. The situation arises from the failure to develop a culture of sustainable internalised fiscal discipline. As a result fiscal pressures which resurged in the latter part of 1998 intensified in the first half of 1999 and appeared to have persisted through the end of the year. The adverse external terms of trade shocks of 1999 thus contributed to an already deteriorating underlying situation. In the event, the lost opportunity in 1998 to build the CEPA-proposed Cocoa Buffer Fund to cushion the economy from the predicted adverse shocks of 1999 appears even more regrettable.

The current economic malaise can also, in part, be attributed to the economic management philosophy adopted in recent years. Since the end of 1995 when the year-on-year inflation rate reached 71 percent, the authorities and our foreign collaborators have made inflation public enemy number one. Although there are several ways of fighting inflation, some unfortunately create problems of their own. Consciously or otherwise, the policy mix chosen has led to high cost of credit for business, difficulties in gaining access to credit and, in the last four years, a perverse case of crowding out of the private sector through payment arrears and non-payment of bills to businesses and individuals. The payment arrears have manifested themselves in increasing private sector credit from the banks — what CEPA has referred to in previous publications as proxy borrowing of government. For those businesses that were not able to seek accommodation from the banks, the crowding-out process has led to enterprise failures and rising unemployment (even if only by casual empiricism), resulting in an increasing incidence of social distress. The latter has, undoubtedly, influenced attitudes towards payment of fees in connection with schooling and health care, among other things.

4.1 The Fiscal-Monetary Nexus: A Historical Perspective

A glance into our economic history confirms the widely-held view that in economies characterised by fiscal dominance, — i.e. fiscal policy considerations dictating monetary policy — monetary policy tends to be accommodating and annual rates of inflation tend to hover around

the critical 40 percent level — a harbinger of prones to hyperinflation. Moreover, in such economies, monetary policy tends to have only short-lived and unpredictable effects on inflation.

Freedom from fiscal dominance implies, in particular, that government borrowing from the central bank is low to nil. It also implies that the government has a broad conventional revenue base and does not have to rely systematically and significantly on proceeds from seigniorage⁴. If fiscal dominance exists, inflationary pressures of a fiscal origin will typically undermine the effectiveness of monetary policy. The central bank is obliged to accommodate the demands of government by, for example, printing the currency to finance government expenditures or restraining interest rates on government securities as a means of reducing the debt servicing burden on the Budget.

Reliance on seigniorage is perhaps the simplest and most common indication of fiscal dominance. The link between a government's inability to raise the revenue it needs from conventional sources and its recourse to seigniorage is well documented. In Ghana, as in many developing countries, this link is strong because of structural features⁵ and a proclivity to abuse seigniorage, particularly in times of elections and crises such as adverse terms of trade shocks.

Perhaps in recognition of these dangers and the experiences pointing to the fact that a necessary condition of monetary policy effectiveness is central bank independence (CBI), the 1992 Constitution made clear provisions for a larger degree of autonomy for the Bank of Ghana. Admittedly, no central bank can be entirely independent of government influence. The concept of CBI used here refers to freedom of the Bank of Ghana in choosing the appropriate instruments to achieve the rate of inflation optimal to the overall economic circumstances and development

⁴ Seigniorage revenues are revenues that accrue to the government (as owner of the central bank) from its having monopoly on issuing domestic money (the cedi in the case of Ghana). For example, even with all the safeguards against forgery and the costs of printing abroad, the profit on a ₵5,000 note may be at least 90 percent.

⁵ These include, among other things, concentrated and unstable sources of tax revenue, poor collection procedures, and skewed income distribution

objectives of the country.

4.2 The National Economic Forum and the Budget

The 1997 National Economic Forum (NEF) had to confront the challenge that, the Constitutional provisions for CBI notwithstanding, monetary policy had tended to be lax and accommodative. Consequently, inflation rates had remained in the dangerous environs of about 40 percent with a peak of 71 percent recorded for 1995 — admittedly, in part, on account of the heightened inflationary expectations triggered by the ill-fated attempt with the VAT. CEPA analysis, however, indicates that even without the VAT, the annual year-on-year inflation would, nonetheless, have been close to 40 percent.

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 balance⁶. A target of a balanced broad budget was set for the year 2001. Guidelines were also provided for the path — i.e. the yearly benchmarks — towards the achievement of the ultimate zero balance objective.

It is important to note that the objective of a balanced budget set by the NEF was more than a matter of fiscal discipline. It also recognised the low savings rate of the Ghanaian economy, resulting in a wide gap between the investment requirements — public and private — and the resources for funding. Relatedly, low domestic savings had contributed to aid-dependence which, over time, had made Ghana a highly-indebted country⁷.

The NEF recommendation has two important implications. First, it requires that enough

⁶ The two measures of fiscal stance used in this report — the overall broad balance and the domestic primary balance — are formally defined and extensively discussed in Section 4.3.

⁷ It may be recalled that more than a decade before the Third World Debt crisis hit the news headlines, Ghana had actually declared unilateral default on her external debt accumulated in the First Republic (the so-called *yentua* policy) after successive debt rescheduling had failed to provide meaningful relief.

domestic primary surpluses are generated to entirely fund expenditures incurred in servicing the national debt. The stark reality is that sub-Saharan African countries have not been major recipients of the large foreign direct investment (FDI) flows around the world. Against this background, the second implication of the NEF recommendation is that it opened up the possibility of using the sovereign powers of the State to mobilise external resources to be rechannelled through the domestic financial institutions to fund private sector investment.

Although an official review of the implementation record of the NEF recommendations has not yet been undertaken, it is largely acknowledged that the target of fiscal balance in year 2001 is unachievable⁸, least of all with the persisting and intensifying adverse consequences of the terms of trade shocks first noted in the latter half of 1999.

4.3 Measures of Fiscal Stance

In order to separate out the effects of different components of fiscal pressure, it has been the tradition for CEPA to use two measures of fiscal stance — the domestic primary balance (DPB) and the overall broad balance (OBB). Since these measures focus on different aspects of the issue, they do not always point in the same direction and, consequently, information from both must be carefully analysed in forming judgements about the fiscal situation. It is, however, true to state that when they point in the same direction they reinforce each other as to the state of affairs.

The Domestic Primary Balance

⁸ In his 2000 Sessional Address to Parliament, the President intimated that the overall budget deficit for 1999 and 2000 would be higher than projected and that the NEF recommended target of a balanced budget by the 2001 would, more likely than not, be in jeopardy. Thus, “in the circumstances, it would be appropriate to re-programme the target balanced budget to a date beyond the year 2001 to make it more realistic and attainable”.

The DPB is the balance of the difference between domestic current revenues (tax and non-tax) and the aggregation of all domestic non-debt expenditures. In excluding debt service charges and volatile flows like external aid and capital receipts such as divestiture, the DPB presents a useful barometer of what may be termed the fundamentals of the fiscal situation. In addition, the DPB provides a measure of the current fiscal effort since interest payments are predetermined by the size of previous deficits. If the DPB is in deficit, it signals a case of potentially unsustainable rising indebtedness. This is because maturing loans and interest payments may have to be paid with further loans. In this process of capitalisation, additional interest becomes payable on interest already due and the debt problem threatens to get out of hand. If the ratio of debt to national income is to decline and stabilise at a sustainable level, then the DPB must, at least, show sustainable surpluses⁹.

The Overall Broad Balance

The OBB includes all domestic current revenues (tax and non-tax) as well as aid inflows such as grants (both programme and project). On the expenditure side are included all domestic non-debt expenditures (current and capital), all interest payments (domestic and external) as well as all aid-financed development expenditures. Also, in a technical sense, the OBB is the DPB plus foreign grants less interest payments and foreign-financed capital expenditures. Thus, inflows of foreign grants improve the OBB. On the other hand, interest payments worsen the OBB. Foreign-financed capital expenditures, as with all expenditures, potentially widen the deficit (or reduce the surplus).

While the OBB is an important tool for assessing fiscal policy, it is a measure that should be judged with some caution. This is because although the OBB offers a perspective on the aggregate demand effects of fiscal policy, it is nevertheless deficient as an indicator of the impact of fiscal policy actions on other policy variables of concern, such as the composition and overall level of economic growth, the monetary stance, and policy sustainability.

⁹ When nominal interest rates on government debt do not exceed nominal GDP growth, then a DPB surplus will imply a falling government debt-to-GDP ratio.

In the nature of things, foreign-financed expenditures are self-financing. This therefore means that the size of foreign-financed expenditures, though important in terms of the measure of the deficit does not matter in the sense of creating domestic borrowing pressure. Foreign-financed expenditures, in the Ghanaian context, tend to be volatile because aid conditionalities and disbursement procedures do not assure steady flows from year to year nor even in line with donor commitments and agreements for any given year¹⁰. For a heavily aid-dependent economy, this volatility could be a serious destabilising factor as public investment is rendered erratic. From a financing perspective, delayed/cancelled disbursements of project aid loans would mean less foreign-financed capital expenditures and, therefore, a lower OBB. This apparent improvement in the fiscal stance is, however, illusory because the future growth of the economy which depends on investment is dampened by the resulting unplanned public investment cutback.

4.4 Overall Assessment of the Fiscal Stance

To eliminate seasonal factors in the analysis of trends in the fiscal stance, annualised measures of the DPB and OBB are used. Again, to enhance comparability over time, ratios of these measures to GDP are preferred. The period of assessment covers the path of the annualised series from AQ298 to AQ399¹¹. These are presented in Table 4.1 and shown in Figure 4.1.

Assessment Using the DPB

The table shows that from the latter part of 1998 the fiscal stance as measured by the DPB has followed a generally deteriorating course. Moreover, the pace of deterioration quickened considerably in 1999 so that by September 1999 the year-to-date DPB had swung (for the first time in the Fourth Republic) from positive to negative. Note has already been taken of the dire consequences in respect of debt servicing that could flow out of a negative DPB. But that

¹⁰ In 1999 \$50 million of Japanese aid was unexpectedly cancelled because of the increased likelihood that Ghana might wish to avail herself of the Highly Indebted Poor Country (HIPC) Initiative which is not supported by Japan.

¹¹ By annualised AQ298 we mean the value of the variable for the twelve month period spanning July 1, 1997 to June 30, 1998. Similarly, annualised AQ399 is the value for the one-year period beginning October 1, 1998 to September 30, 1999. Annualised AQ498 is therefore equivalent to calendar year 1998.

this should occur in a period of high and rising indebtedness both internally and externally bodes ill for future economic prospects since high debt servicing requirements could displace much-needed expenditures for social and economic services. Perhaps in recognition of these difficult choices, a proposal was placed before the last donors' meeting in Accra for the creation of an Internal Debt Relief Fund.

	Domestic Primary Balance	Overall Broad Balance
AQ298	1.5	-9.5
AQ398	2.1	-8.0
AQ498	2.0	-7.9
AQ199	0.9	-8.0
AQ299	0.1	-8.2
AQ399	-1.0	-8.7
AQ499	-1.1	-9.2

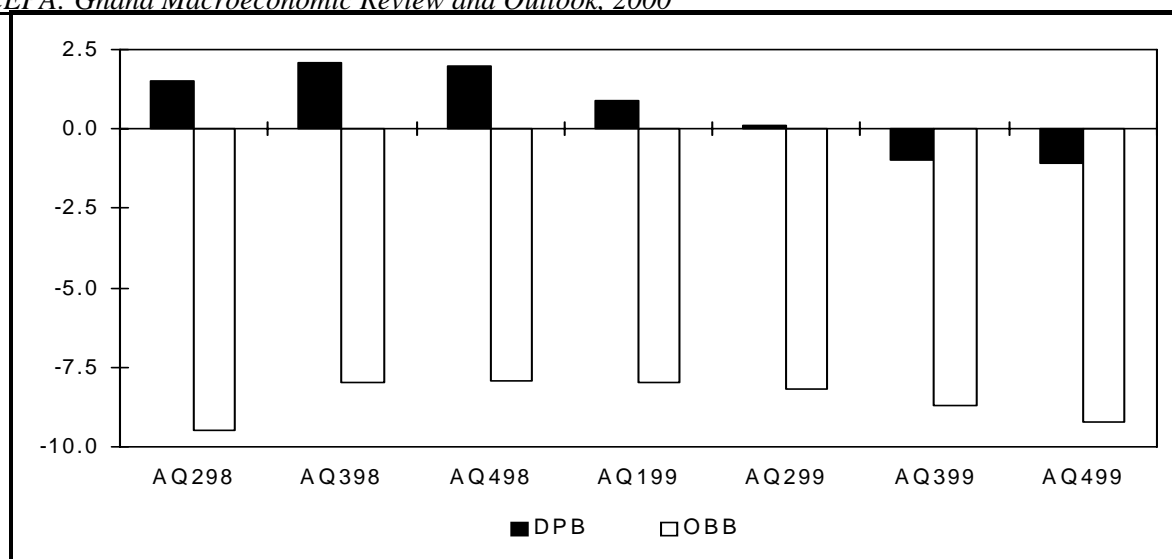
Source: IMF, BOG, CAGD, CEPA Staff Estimates

All the indicators clearly point to a pre-existing adverse trend which has been accentuated by the terms of trade shock. In this regard the challenges posed for the year 2000 and into the medium-term are more severe than those of the recent past. Widening fiscal imbalances threaten to further destabilise the macroeconomic environment.

Assessment Using the OBB

The time path of the OBB is almost identical to that of the DPB – a generally worsening trend whose slope has steepened by, among other things, the adverse terms of trade shocks of the second half of 1999. Moreover, the adverse consequences and, therefore, the accelerated pace of deterioration is projected into this – an election – year.

As noted above, delayed/cancelled project loan disbursements – which are reflected in reduced foreign-financed capital expenditures – can give a semblance of improvement in the fiscal



stance from the perspective of the OBB. Reduced investments, however, would imply potentially diminished future growth prospects. It thus becomes clear that such apparent financial improvement is more of a mirage than a sign of progress. In this regard note must be taken of the steady decline in the ratio of foreign-financed capital expenditure to GDP. Together with higher receipts of foreign programme grants they created a false impression of improvement in the fiscal position in the earlier period.

The interest payments share of GDP has, in similar vein, generally trended downwards which, ordinarily, would be a much welcome development. The problem is that the trend is unsustainable and likely to show a sharp reversal in the year 2000. The major driving force to the “healthy” development has been the somewhat rapid fall in nominal yields on government Treasury bills – the primary instrument of official borrowing. The main explanatory factors on both the demand side and supply of the Treasury bills market behind the otherwise salutary development, however, appear likely to change for the worse.

On the demand side, the deposit money banks (DMBs) have shown a remarkably strong preference for domestic assets compared to foreign. Consequently, over the 1998/99 period, the consolidated balance sheet of the DMBs showed substantial reductions in their net foreign assets and an even more rapid build-up of net domestic assets, especially of Treasury bills. These portfolio shifts have maintained high demand pressure in the Treasury bills market, keeping prices high and rising and, consequently, contributing to lowering yields. There are growing signs that with

the terms of trade shocks heightening fears of a currency crisis – which actually occurred in the fourth quarter of 1999 – the DMBs would, in all likelihood, begin a serious re-examination of their portfolio management strategies. To the extent that this results in a reduced demand for Treasury bills, interest yields would tend to rise.

On the supply side, the institution of a cash budget policy by the Bank of Ghana has led to a situation in which government cheques, including for VAT refunds to exporters, are being bounced or bearers being repeatedly asked to re-present these cheques for payment. The failure of the BoG to honour government cheques on presentation is naturally the driving force behind the growing stock of payment arrears on-going over the last four years.

The interest rate policy of the BoG has apparently restrained the Treasury from selling Treasury bills in the quantities required to finance government expenditures. The result has been a slow down in the growth of official debt – falling ratio to GDP – even as the Treasury bill rate declined. Indeed when faced with an increased need for domestic borrowing in the face of disruptions in aid disbursement in the first half of 1999, the BoG preferred deficit financing – literally resort to the printing press – rather than large placements of Treasury bills on the market which might raise interest payments in the government's accounts.

The practice of not honouring government cheques has now become so rampant that apart from its apparent illegality it is threatening to bring the entire payments system into disrepute, if not worse. The stock of arrears is estimated to be about 5 percent of GDP as of end-December 1999. There have been persistent reports that unpaid teachers and other suppliers of goods and services to government institutions, especially road building contractors, have been stepping up their demands for rectification of the situation. If at no other time, an election year is not one to allow for further growth of the payments arrears stock. Consequently, the supply of Treasury bills is most likely to increase sharply in the course of the year 2000 which could mean a return to high and rising interest rates. Meanwhile, the sharp depreciation – largely one of technical correction – of the cedi in the fourth quarter and likely further future developments would tend to raise interest payments on the external public and publicly-guaranteed debt currently estimated at a little over \$6 billion (including that owed to the IMF).

4.5 Financing of Government's Fiscal Operation

A complete assessment of the fiscal policy stance must take account of the way the way the deficient is financed, since different financing modes carry with them particular macroeconomic costs and effects. On account of shortfalls in net external financial assistance as well as the dwindling proceeds from the divestiture programme, government's recourse to domestic sources to finance budgetary gaps has deepened. On an annualised basis, an exceptionally large share – a little over 86 percent as of mid-1999 and nearly 80 percent by the end of the third quarter– of government borrowing had to come from domestic sources. This compares with 65.5 percent and 53.5 percent, respectively, for the corresponding periods of 1998 and 64.4 percent for calendar year 1998.

	<i>AQ298</i>	<i>AQ398</i>	<i>AQ498</i>	<i>AQ199</i>	<i>AQ299</i>	<i>AQ399</i>	<i>AQ499</i>
Domestic Revenues	14.9	14.8	15.4	14.9	14.8	14.1	14.5
Domestic Non-Debt Expenditures	13.4	12.6	13.4	14.0	14.6	15.1	15.6
DOMESTIC PRIMARY BALANCE (DBP)	1.5	2.1	2.0	0.9	0.1	-1.0	-1.1
Foreign Grants	3.0	3.4	3.0	2.9	2.5	2.1	2.4
Interest Payments	6.1	6.0	6.1	5.6	5.4	5.0	5.2
Foreign-Financed Capital	8.0	7.6	6.8	6.2	5.4	4.7	5.3
OVERALL BROAD BALANCE (OBB)	-9.6	-8.0	-7.9	-8.0	-8.2	-8.7	-9.2
TOTAL FINANCING <i>of which:</i>	9.6	8.0	7.9	8.0	8.2	8.7	9.2
1. Divestiture Receipts	0.9	0.8	0.6	0.3	0.2	0.2	0.2
2. Borrowings	8.8	7.2	7.3	7.7	8.0	8.4	9.0
<i>(a) Foreign (net)</i>	3.0	3.4	2.6	2.0	1.0	0.7	0.9
Programme Loans	0.7	1.3	1.2	1.0	0.7	1.1	1.1

Project Loans	5.2	4.8	4.4	4.0	3.6	3.0	3.4
Amortisation	-3.0	-2.7	-3.0	-3.0	-3.4	-3.4	-3.5
<i>(b) Domestic (net)</i>	5.8	3.8	4.7	5.7	7.1	7.7	8.1
<i>Formal</i>	3.9	3.0	3.7	4.0	4.9	5.0	5.1
Banking	3.6	0.3	1.7	2.3	3.8	5.5	4.5
BoG	-2.0	-2.4	-2.0	-1.7	0.4	1.1	0.9
DMBs	5.6	2.7	3.7	4.0	3.4	4.4	3.7
Non-Bank	0.2	2.7	2.0	1.7	1.2	-0.5	0.6
<i>Informal (Arrears)</i>	2.0	0.8	1.0	1.7	2.1	2.7	3.0

Source: IMF, BOG, CAGD, CEPA Staff Estimates

Borrowing using both formal and informal instruments increased during the period, with the former increasing from 3 percent of GDP as of Q398 to 5 percent of GDP at the end of Q399, while the latter rose from just under 1 percent of GDP to 2.1 percent of GDP over the same period.

Furthermore, the breakdown of this large formal domestic borrowing by government reveals some rather disturbing developments. Borrowing from the banking system amounted to 3.8 percent of GDP compared to 3.6 percent of GDP a year before and only 1.7 percent for calendar year 1998. Even more disturbing was the resort to borrowing from the Bank of Ghana – literally printing money – and in the process reversing a “laudable” recent trend of government fiscal operations contributing positively to monetary restraint, albeit at the expense of a build-up of payment arrears.

Again the period marked an acceleration in the process of payment arrears build-up. Borrowing through this informal channel constituted nearly 30 percent of the total domestic borrowing need at the end of Q399, up from about 21 percent at the end of Q398. This marked escalation in payments arrears threatens the entire payments system in the country as government cheques increasingly failed to be honoured by the Bank of Ghana. As already been noted above, the medium- to long-term detrimental consequences in terms of enterprise failures, bankruptcies, diminished growth prospects, rising unemployment, and widespread poverty are likely to be very

costly and irrevocable.

Net domestic financing excluding payments arrears exceeded its ESAF programme ceiling by 1.6 percent of GDP. Given this higher than planned recourse to domestic financing, further excesses could contribute to a weakening of monetary policy with increased likelihood of rekindling inflationary expectations. This latter is feared as leading to wage demands similar to those that derailed the programme in 1992. On the other hand, an acceleration in the rate of payments arrears accumulation could raise interest rates and crowd out the private sector in domestic credit markets.

4.6 Domestic Revenues

Domestic revenues have tax and non-tax components. Official estimates of collections for the first half-year show non-tax receipts lower than projected by about €25 billion reportedly on account lower BoG profits in 1998. In the first half of the year, weaknesses in non-tax revenue – revaluation gains in respect of gross foreign assets of BoG recorded in the exchange equalisation account which seems to be classified as a component of the government accounts/deposits at the BoG. The problem with this explanation is that it reveals a programme design flaw inasmuch as the profit and loss position of the central bank should have been known at the time of putting together the Budget. CEPA has been drawing attention to the lack of clarity about the nature of what, in recent years, has become the major revenue items of government – domestic non-tax revenues – without any credible official response. As a result the CEPA estimate of the shortfall of about €110 billion is smaller than the official estimate. For the year as a whole, CEPA’s estimates of non-tax receipts amounted to €90.6 billion, some €220 billion below the official projection.

Table 4.3 : Domestic Revenue Performance (% of GDP)

	AQ298	AQ398	AQ498	AQ199	AQ299	AQ399	AQ499
CEPS Tax Collections	5.5	5.3	5.5	5.2	5.2	4.9	5.1
IRS Tax Collections	4.3	4.2	4.1	4.1	4.0	4.0	4.2
VAT/Sales/Service	2.9	2.9	3.2	3.0	3.1	3.3	3.6
Cocoa ExportsTax	1.9	2.1	2.2	2.0	2.0	1.4	1.2

TAX REVENUE	14.6	14.5	15.0	14.4	14.3	13.6	14.1
DOMESTIC NON-TAX REVENUE	0.3	0.3	0.4	0.5	0.5	0.5	0.4
TOTAL DOMESTIC REVENUE	14.9	14.8	15.4	14.9	14.8	14.1	14.5

Memo Items

Tax Revenue (Excl. Cocoa)	12.7	12.4	12.8	12.4	12.3	12.2	12.9
Divestiture & NPART	0.9	0.8	0.6	0.3	0.2	0.2	0.2
Foreign Grants	3.0	3.4	3.0	2.9	2.5	2.1	2.4
Program	0.4	0.7	0.5	0.6	0.6	0.3	0.4
Project	2.6	2.8	2.4	2.2	1.8	1.7	1.9

Source: IMF, BOG, CAGD, CEPA Staff Estimates

Tax revenues, in contrast, appeared largely on target although performance varied for different tax categories. On an annualised basis, performance in the first half-year – at 14.3 percent of GDP – was somewhat below that for the corresponding period of 1998 – 14.6 percent of GDP. Two of the revenue collecting agencies – CEPS and IRS – were responsible for the relatively poorer outcome for 1999. In contrast, the VAT Secretariat showed improvement in its collections as was collections from cocoa export duties. The falling price of cocoa in world markets impacted markedly in the second of the year as the share of cocoa export duties dropped from 2.0 percent of GDP by mid-year to 1.2 percent at the close of the year. Correspondingly, the share of total taxes in GDP fell from 15 percent in fiscal 1998 to 14.1 percent in fiscal 1999.

CEPS Collection

The Customs, Excise and Preventive Service (CEPS) has responsibility for the collections of duties and taxes (except the VAT) on imports, excise duties on domestic goods as well as taxes levied on petroleum products. On an annualised basis collections up to end-December 1999 represented 5.1 percent of GDP which was below the 5.5 percent of GDP for the corresponding period of 1998. Of the three broad tax categories, import duties and taxes was the only one that held its ground in 1999 when compared to the 1998 performance of 2.5 percent of GDP. Excise duty on domestic goods recorded a performance diminution dropping from 0.9 percent of GDP in 1998 to 0.7 percent of GDP in 1999. Collections of taxes on petroleum products dropped to 1.9 percent of GDP in 1999 from 2.1 percent of GDP in 1998. Delayed adjustments in ex-refinery prices in the face of sharp international market prices and/or sharp depreciation of the exchange rate could erode taxes.

The effective duty rates on imports have been adversely affected by the large upward revision of the value of imports. Press reports of significant leakage of duty collection through bonded warehouses have been common. One report named the figure of ₵300 billion at the time of the Fund Mission's visit in September. Officials alleged to have been involved are reported to have been suspended pending completion of investigations. About ₵28.8 billion in revenue losses are said to have been traced to identified individuals or firms of which ₵6 billion is said to have been recouped already. The problem as to whether and to what extent the imports into the export processing zone (EPZ) are included in the bonded warehouses has not been properly answered. This leaves a cloud of uncertainty as to the appropriate import value to use as the basis for assessing performance of import duty collections.

Table 4.4: CEPS Tax Collections (% of GDP)

	<i>AQ298</i>	<i>AQ398</i>	<i>AQ498</i>	<i>AQ199</i>	<i>AQ299</i>	<i>AQ399</i>	<i>AQ499</i>
<i>CEPS Tax Collections</i>	5.5	5.3	5.5	5.2	5.2	4.9	5.1
Import Duties & Taxes	2.6	2.5	2.5	2.4	2.4	2.4	2.5
Domestic Goods & Services	2.9	2.8	3.0	2.8	2.8	2.5	2.6
<i>Excise Duties</i>	0.7	0.8	0.9	0.9	0.9	0.8	0.7
<i>Petroleum Taxes</i>	2.2	2.0	2.1	1.9	1.9	1.7	1.9

Source: IMF, BOG, CAGD, CEPA Staff Estimates

IRS Collections

The Internal Revenue Service (IRS) has responsibility for collections of four tax categories – personal income tax (PAYE), taxes on the self-employed, corporate income taxes, and a miscellaneous group including taxes on rent income. Overall performance for the year showed a marginal improvement in performance – 4.2 percent of GDP in 1999 compared to 4.1 percent of GDP in 1998 – mainly on account of a better second half-year outcome. As noted earlier, performance varied across the different categories. Thus while collections of PAYE taxes improved from 1.2 percent of GDP to 1.3 percent of GDP in 1999, that of company taxes declined from 2.1 percent of GDP to 2.0 percent of GDP in 1999. Income taxes on the self-employed, as with taxes in the miscellaneous group, held steady over the two fiscal years under consideration – the former at 0.2 percent of GDP and the latter at 0.6 percent of GDP.

Table 4.5: IRS Tax Collections (% of GDP)

	AQ298	AQ398	AQ498	AQ199	AQ299	AQ399	AQ499
IRS Tax Collections	4.3	4.2	4.1	4.1	4.0	4.0	4.2
Personal Income (PAYE)	1.4	1.4	1.2	1.1	1.2	1.2	1.3
Self-Employed	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Companies	2.0	2.0	2.1	2.2	2.2	2.2	2.0
Other (incl. rent)	0.6	0.6	0.6	0.5	0.4	0.4	0.6

Source: IMF, BOG, CAGD, CEPA Staff Estimates

Collections by the VAT Service

The VAT Secretariat is relatively new and charged with responsibility for the collection of VAT on both domestic and imported goods and services. The VAT — at 10 percent rate — replaced the sales and services taxes — at 15 percent rate — effective January 1, 1999. The comparisons made here, therefore, refer to sales/services taxes or VAT as appropriate for the period under consideration. The improved performance recorded by the VAT Secretariat was on account of collections on imports — 2.1 percent of GDP for 1999 compared to 1.6 percent of GDP for the 1998 period. Domestic collections held steady at 1.6 percent of GDP for the two periods. These outcomes clearly demonstrate the well-known higher efficiency of the VAT as a

tax handle over the sales tax. Thus in spite of a lower rate, collections were not only comparable but reached the higher targets set for 1999.

Table 4.6: Value-Added Tax Collections (% of GDP)

	AQ298	AQ398	AQ498	AQ199	AQ299	AQ399	AQ499
<i>VAT/Sales/Service</i>	2.9	2.9	3.2	3.0	3.1	3.3	3.6
Domestic	1.3	1.3	1.6	1.5	1.4	1.4	1.5
Import	1.6	1.6	1.6	1.6	1.6	1.8	2.1

Source: IMF, BOG, CAGD, CEPA Staff Estimates

Cocoa Export Taxes

Without a more depreciated exchange rate, the decision to maintain the producer price of cocoa unchanged in the wake of the decline in world cocoa prices is simply untenable. But this is why the discussion about the share of the world market price accruing to the farmer and of the consequences — a precipitous cut in government revenue, which will need to be made up urgently as Parliament was told — is at best misleading if not disingenuous or plainly mischievous.

Although shipments, as expected, were lower in 1999 than in 1998, average effective international market prices for cocoa were higher in the first half of 1999 than the corresponding half of 1998 — \$1727 per tonne in 1999 as against \$1647 per tonne in 1998. In addition, the exchange rate was more depreciated. On the other hand, the cocoa producer price per tonne paid to farmers remained unchanged at ¢2.25 million per tonne. The result of all these developments, put together, was an improved cocoa export duty collection in early 1999. On an annualised basis, collections improved, albeit marginally, from 1.9 percent of GDP fro 1998 to 2.0 percent of GDP fro 1999. The maintenance of the nominal cocoa producer price, although implying a decline in real terms — allowing for inflation — has been the subject of much public comment and discussion. This is because steep price falls occurred in international markets. However, because of the marketing strategy of COCOBOD, this did not affect average prices recorded in the first half-year.

When the effects of the external price declines are taken into account for the year as a whole, the maintenance of the nominal cocoa producer price raised the producers' share in the f.o.b. price to 65-75 percent at unchanged exchange rates. On the other hand the share of cocoa export duty in GDP dropped drastically from 2.2 percent in 1998 to only 1.2 percent in 1999.

The official reason for the retention of the nominal producer price was that in spite of the consequential increased share of the f.o.b. price, it was equitable and served to protect the rural poor from the effects of the external shock. On the other hand, without a more depreciated exchange rate the retention would be untenable. The positive aspects — sustaining producer incentives, eliminating inequitable export taxes, and restraining the rise in rural poverty — would, sooner than later, be more than offset by the precipitous cut in government revenue which will have to be urgently made up. A question has also been raised about the emergence of a sizeable volume — almost 40,000 tonnes — of relatively inferior cocoa beans (believed to be smuggled from Cote d'Ivoire). With unchanged exchange rates, the producer price is not profitable when exported unless the cocoa purchased has "main crop characteristics". A two-tier producer price system may become necessary to cope with differences in cocoa bean characteristics and their prices in world markets. The feasibility or practicability of such a pricing system and its effect on Ghana's long-natured price premium on the world market needs to be carefully considered.

Divestiture and NPART Proceeds

These are estimated at $\text{¢}53$ million for 1999 with 96 percent accruing in the third quarter. The first half-year inactivity has led to the conclusion that the programme has lost its momentum, both in terms of completing new divestitures and collecting revenues from previous sales. This year's programme envisaged the completion of sales of SIC and GHACEM as well as the offer for sale of PBC and GOIL. The remaining government shares in banks were also targeted for divestiture.

4.7 Government Expenditures

Domestic Non-Debt Expenditures

Domestic non-debt expenditures broadly consist of personal emoluments (Item 1), transfers to SSNIT and to households of pensions and gratuities, purchases of goods and services (Items 2-5), subventions to public and private non-profit institutions and organisations (Item 6) and capital expenditures. The latter comprises domestically funded development expenditures (Items 7,8,&9), transfers to the District Assemblies through the District Assemblies Common Fund (DACF), and Net Lending to enterprises both public and private.

In previous CEPA reports some issues have been raised about the budgetary estimates and the budgetary process itself. For example, on the basis of data compiled by the Controller and Accountant General (CAG), CEPA pointed to the increasing irrelevance of the budgetary hearings and the Parliamentary approval process. This is because of high incidence of expenditures incurred without prior Parliamentary approval as well as expenditures far below the approved estimates — savings that on closer examination turned out invariably to be payments arrears. CEPA analyses, moreover, showed the payments arrears problem to be an on-going process which extended beyond the roads sector. Official provisional actuals, therefore, tended to be on payments rather than on commitments basis.

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.

	AQ298	AQ398	AQ498	AQ199	AQ299	AQ399	AQ499
RECURRENT EXPENDITURE	15.9	15.2	16.2	15.6	15.6	15.7	16.0

Non-Debt	9.8	9.2	10.1	10.1	10.2	10.7	10.8
Personal Emoluments	5.4	5.2	5.3	5.2	5.2	5.6	6.2
Transfers	1.4	1.4	1.4	1.4	1.3	1.4	1.5
Social Security	0.6	0.6	0.6	0.6	0.6	0.6	0.7
Pensions & Gratuities	0.8	0.8	0.8	0.8	0.8	0.7	0.8
Special Efficiency	0.0	0.0	-	-	-	-	-
Items 2-5	1.6	1.3	2.0	2.1	2.2	2.3	1.8
Environment & Emergency Fund	-	-	-	-	-	-	-
Subventions	1.4	1.2	1.5	1.4	1.5	1.5	1.3
Interest Payments	6.1	6.0	6.1	5.6	5.4	5.0	5.2
Domestic	4.7	4.7	4.9	4.4	4.3	4.0	4.0
External	1.5	1.3	1.2	1.1	1.1	1.1	1.3
CAPITAL EXPENDITURE	10.3	9.9	9.1	8.9	8.2	7.1	7.9
Domestic Financed	2.4	2.3	2.3	2.6	2.8	2.4	2.6
Development	1.5	1.3	1.3	1.7	1.9	1.6	1.9
Net Lending & Equity	0.2	0.3	0.3	0.3	0.2	0.1	(0.0)
D. A. Common Fund (DACF)	0.7	0.7	0.8	0.7	0.7	0.7	0.7
Foreign Financed	8.0	7.6	6.8	6.2	5.4	4.7	5.3
ARREARS (net) - non statutory	1.3	1.1	1.0	1.3	1.6	2.0	2.2
TOTAL EXPENDITURE (commitments)							
Domestic Non-Debt	13.4	12.6	13.4	14.0	14.6	15.1	15.6
Broad	27.5	26.2	26.3	25.8	25.5	24.9	26.1

Source: IMF, BOG, CAGD, CEPA Staff Estimates

On a commitments basis, CEPA estimates recurrent domestic non-debt expenditures for

the first half-year of 1999 at ₵1059.6 billion. This is ₵113.1 billion i.e. 11.9 percent higher than the official estimate. A major source of difference is in respect of personal emoluments. In April 1999 the government adopted a new salary structure — the Price Waterhouse Report— as providing a medium-term framework for public sector employee remuneration. This was also to eliminate the tensions and uncertainties that have characterised the yearly negotiations at the Tripartite Committee — of government, representatives of the business community, and the unions. An important objective of the new salary structure was the elimination of various allowances for rent, car maintenance, among others, by incorporating them into one consolidated wage. After extensive discussions agreement was finally reached and the new salary structure became effective in June, retroactive to the beginning of the year. The resulting average wage increase of 20 percent for 1999 interestingly happened to coincide with the assumption made in the ESAF arrangement approved in May. Actual payments in respect of the first half-year, however, were not made until July, implying an addition to the stock of arrears. The actual payments reported in the official statistics have been, therefore, adjusted to bring the estimates to a commitments basis. The difference amounts to ₵98.1 billion. In addition, and for consistency, the social security obligations of government have been increased by ₵15.1 billion. For lack of data on individual expenditure items, all the other recurrent domestic non-debt expenditures are the official (payments basis) provisional actual estimates. For the entire fiscal year as whole, the CEPA estimate of domestic non-debt expenditures amounted to ₵3414 billion which is about 17 percent higher than the official statistics would indicate.

Domestic Non-Debt Recurrent Expenditures

On an annualised basis, domestic non-debt recurrent expenditures in the first half-year represented 10.1 percent of GDP as compared to 9.7 percent of GDP in respect of the corresponding period of 1998. In spite of the increase over the previous year, it compares favourably with the target in the ESAF programme of 10.4 percent of GDP for calendar year 1999. The major components show varied results. Personal emoluments for the 1999 period represented 5.2 percent of GDP, which may be considered an improvement over the 5.4 percent of GDP of the 1998 period. It must be noted that there were strong representations from labour in regard to alleged serious anomalies whose correction would likely increase the wage bill.

At the same time, it is noted that the ESAF target for calendar 1999 is higher at 5.7 percent of GDP but this does not provide room for any necessary corrective measures to be taken within the guidelines agreed with the Bretton Woods Institutions (BWIs). This is because the higher GDP ratio is on account of a lower projected nominal GDP assumption. The ESAF ceiling notwithstanding, the wage bill share of GDP for calendar 1999 shot up to 6.2 percent in response to moves by government to correct the alleged anomalies.

Transfers as percent of GDP were marginally higher in 1999 (1.5) compared to 1998 (1.4) and much higher than the ESAF target for 1999 (1.2). Purchases of goods and services (Items 2-5) totalled the equivalent of 1.8 percent of GDP for 1999 compared to 2.0 percent a year earlier. The ESAF target was also 2.0 percent GDP. Finally, subventions constituted 1.3 percent of GDP for the 1999 period, somewhat lower than the 1.5 percent of GDP for 1998.

On the capital side, domestic non-debt expenditures totalled ₵568.6 billion which was ₵281.4 billion lower than the official estimate of ₵850 billion. The discrepancy is on account of classification problems associated with expenditure monitoring. As noted in a previous CEPA publication, the CAG reports an inability to provide estimates of foreign-financed expenditures because donors deal directly with the ministries, departments and agencies (MDAs) without passing resources through the Consolidated Fund as mentioned in Constitution which would bring these transactions to the notice of the CAG. On the assumption that all these resources, however, are recorded in the GoG accounts at the BoG, under-reporting of donor-financed expenditures would necessarily result in over-estimates of domestically-funded expenditures to bring revenues and expenditures into consistency with financing. As will become apparent later the official estimate of foreign-financed capital expenditures is less than 23 percent of the actual estimate based on aid disbursements. Correcting for this error leads to a downward adjustment of the estimate of the domestically-funded capital expenditures.

On an annualised basis, domestic non-debt capital expenditures for fiscal 1999 amounted to 2.6 percent of GDP which is higher than the 2.3 percent of GDP for the corresponding period of 1998. The entire increase was on account of the development expenditure. The revised ESAF target for the fiscal year — calendar 1999 — was 4 percent. It must be noted, however, that the

CEPA estimates are on payments rather than commitments basis. This is because, in the absence of the detailed data on expenditure items usually provided the CAG, it is not possible for CEPA to provide estimates of this expenditure category on a commitments basis. In this regard it may be noted that the net build-up of non-statutory arrears for the period is estimated at ₵230 billion, most of which is in respect of this expenditure category especially in the roads sub-sector. This is equivalent to 1.6 percent of GDP which could bring the final estimate in the environs of the ESAF target for calendar 1999.

Interest Payments on the National Debt

Interest payments for fiscal 1999 — domestic and external — are estimated at ₵1151.0 billion. This is ₵54.4 billion more than the total for the 1998 fiscal. The continued decline in nominal interest rates is no doubt an important contributor to the realised outcomes although higher than programmed domestic financing of the Budget — the result of delays in disbursements — and faster depreciation of the exchange rate have offset some of the gains expected. On an annualised basis interest payments represented 5.2 percent of GDP for 1999, substantially lower than the 6.1 percent of GDP for fiscal 1998. It also compares favourably with the 5.5 percent of GDP target in the ESAF programme.

Domestic interest payments for the complete year were lower than projected — by about 0.3 percent of GDP. Ghana's official debt burden is heavy in comparison with other countries, crowding out priority expenditures and raising concerns regarding debt sustainability. Ghana's official domestic debt compares with that of Cote d'Ivoire — 19.3 percent of GDP against 20.8 percent of GDP and 105.5 percent of total revenue against 97.4 percent of total revenue for Ghana and Cote d'Ivoire, respectively. These two countries show higher levels of indebtedness than most of the member states of ECOWAS and certainly the other members of UEMOA. Higher interest rates, — reflecting high rates of inflation — however make Ghana's debt servicing more burdensome. The comparative figures for interest payments are 5.2 percent of GDP and 28.4 percent of total revenue compared to 0.5 percent GDP and 2.3 total revenue, respectively. It should be noted that in April the BoG lowered its rediscount rate from 32 percent to 27 percent. Deposit and lending rates of DMBs declined by about 5 percentage points. The T-bill rate also fell a couple of points to 24 percent by end June. These declines proved

unsustainable and were reversed later in the year.

The larger than programmed domestic financing of the government Budget and the reversal of trends in respect of interest rates are likely to raise the domestic interest bill above the programme level. At the same time the adverse terms of trade shock and the need for corrective measures on the increasingly over-valued exchange rate could raise the external interest payments substantially above the program target. Thus unless resource mobilisation efforts are intensified and expenditure monitoring and control significantly improved, both the domestic primary and overall broad deficits could widen with difficult financing problems in their wake.

5. REVIEW OF MONEY, PRICES AND FINANCE

5.0 Introduction

There was an uneasy calm in the financial market for most of the year, with the capital market in particular demonstrating a dullness in performance very much in contrast with the year before. Monetary management in 1999 continued to be restrained in the face of dire fiscal constraints, with complete and almost contemptuous disregard for other developments in the economy. The result was that all the financial indices continued to show positive trends without yielding the required response from the real side of the economy. Money was squeezed to minimal growth, the rate of inflation continued to show declining trend as was the nominal rate of interest, while the nominal exchange rate appeared stable; yet stock market activity and investment response was very poor. One supposition is that the economy of Ghana is still very much public sector driven, thus, a slow down in public sector activity due to fiscal inadequacies forces other sectors to slow down. Moreover, when monetary policy reduces to liquidity management, it institutes a dichotomy between the nominal and real sides of the economy. Hence the real sector can refuse to be moved by the niceties of the monetary sector.

5.1 Monetary Management

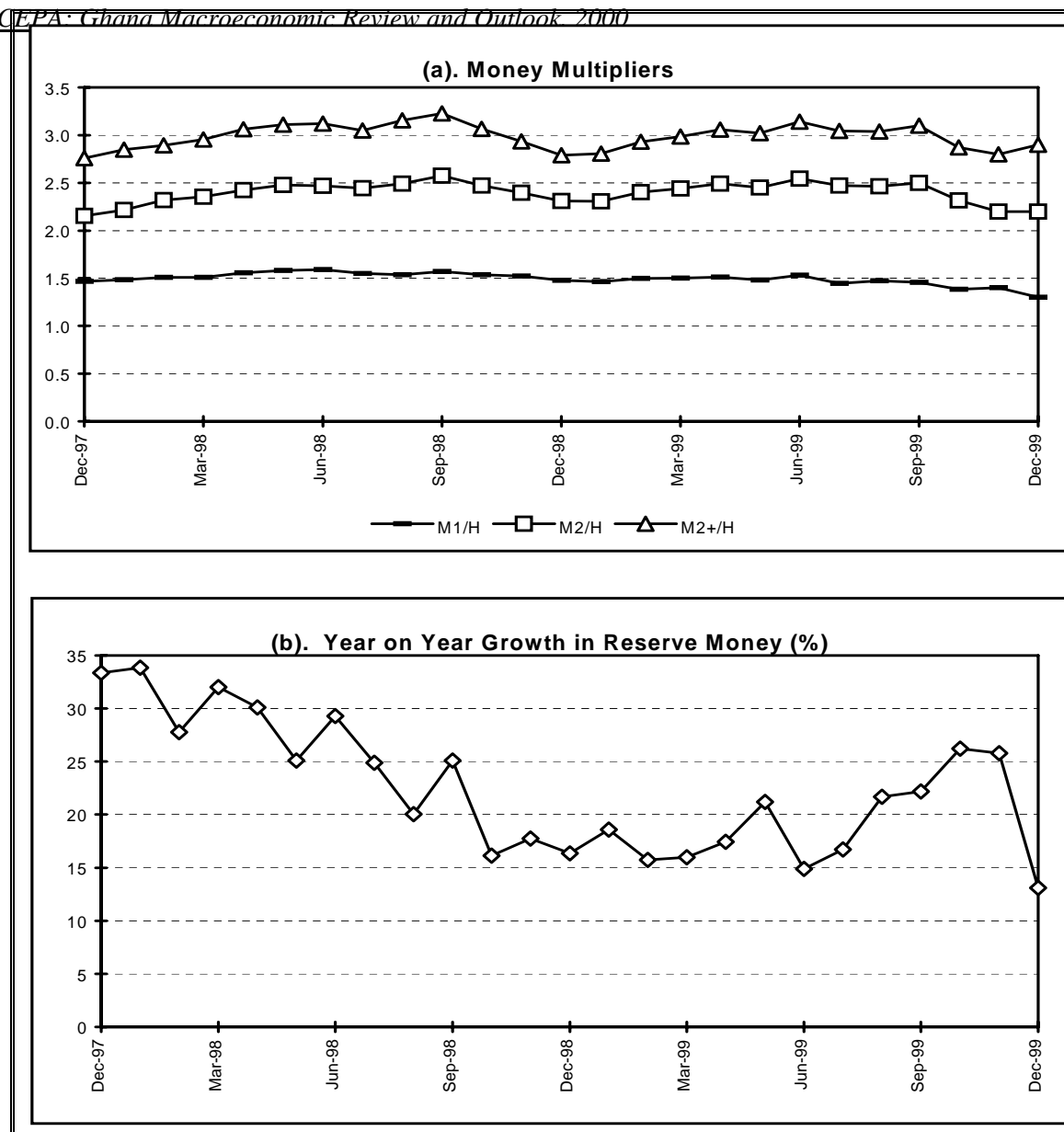
From the point of view of the central bank inflation was still ‘public enemy number one’. Thus the main objective of monetary policy was “to sustain the declining trend in the rate of inflation” (Bank of Ghana, *Quarterly Economic Bulletin*, April-June, 1999). This objective, and the desire to stay within the financial limits agreed to with the IMF in the ESAF programme compelled the central bank to focus unduly on liquidity management in stead of monetary management. In our opinion when the central bank pursues policies which focuses on the attainment of financial targets to the neglect of elements that will promote real sector activity such policies constitute liquidity management. On the other hand, monetary policies which also act on the real sector, usually through the rate of interest (*a la Keynes*) will be termed monetary management. The main instrument for liquidity management is the Repurchase Agreements (**Repo**) while monetary management is carried out through the open market operations (OMO). Note that the **Repo** rates are negotiated rates and do not fully reflect market forces.

In line with the restrictive nature of monetary policy, the rate of interest was not allowed

to decline at the same rate as the fall in the officially reported rates of inflation. The Bank rate was lowered from 37% in December 1998 to 32% in January 1999 and further to 27% in April 1999. Given that the rate of inflation for the period was, on the average, around 10 percent per annum, the real rate of interest by April 1999 was still in excess of 17 percent. This certainly was too high to induce domestic investment in an economy where domestic demand has a higher propensity to import. (Note that over the same period the rate of depreciation of the cedi against the dollar was about 8 percent implying continued real exchange rate appreciation).

The unwillingness of the central bank to allow deficit financing pressures to filter into the money market was also evidenced by the continual fall in the treasury bill rate till about the end of the third quarter of the year. The Treasury bill rate dropped by about two-percentage points between January and September 1999 to about 24.5 percent. This was in spite of the build-up of arrears in the system. By the last quarter of the year, fiscal pressures had started edging the treasury bill rate up slightly, forcing the year to close on a higher rate than it had began.

By its tight policy, the Bank of Ghana managed to reduce the Reserve money from 1,400 billion cedis in January to 1,286 billion cedis in June, representing a drop of about 8 percent for the half year period. Correspondingly, the money multiplier edged up from 2.3 to 2.5. In the final analysis, the stock of money supply rose by only 1 percent in the first half of the year.



Clearly, all the efforts of the Bank of Ghana have been focussed on reducing the rate of inflation to the exclusion of all other economic goals. In the last quarter of the year, the COCOBOD secured a loan of about 350 million US dollars to purchase cocoa for the 1999/2000 season. However, there were rumours of cocoa farmers not having their Akafo cheques honoured. *The Daily Graphic* of December 20, 1999 reported on its front page the protest by farmers at Agona Swedru against the non-payment of their cocoa purchased by the COCOBOD. Two days later the same paper carried a directive by the Minister for Food and Agriculture to the banks to pre-finance cocoa purchases. Why should a minister order banks to pre-finance cocoa purchases — unless the fact of the matter is that they are credit worthy and the non-payment is

through no fault of the ministry or the COCOBOD.

Under normal circumstances the central bank, which receives the foreign currency loan, would credit the COCOBOD's local bankers with the cedi equivalent of the loan and then use the open market operations to mop the excess liquidity from the system. This form of sterilization would conform to the usual form of monetary management: viz, this mopping up process would have affected the interest rate which acts as the interface between the nominal and the real sides of the economy. However, events in the last quarter of the year gives cause to suspect that the central bank must have used a different management system which while respecting the financial benchmarks in the ESAF denied the cocoa sector the needed liquidity.

Box 5a: An Illustration of Liquidity Management of Cocoa Credit

COCOBOD obtains a foreign credit line to the tune of about 319 million US dollars. This credit is sold to the Bank of Ghana and thus improves the net foreign assets position of the central bank. Assuming an average exchange rate of about 3000 cedis/dollar, the COCOBOD's local bankers' accounts get credited with about 1 trillion cedis. However, this swells the Reserve/Deposit ratio of the Deposit money banks and may lead to intense money creation activity by the banks. In addition, it will cause the Bank of Ghana's balance sheet to swell with a ballooned Reserve Money. It may be noted that the Reserve Money ceiling in the ESAF is to be "adjusted downward to the extent of any reduction in or shortfall in compliance with the legal reserve requirement (8 percent of bank deposits)".

Since December 1998, it appears the banking system has a "revealed" Reserve/Deposit ratio position of 0.11. If this is to be achieved, the Cedi deposits of COCOBOD can be run down for purposes of cocoa purchase to the tune of ₵134.2 bn which is equivalent to 59.6 thousand tonnes. This compares unfavourably with the about 120 thousand tonnes if the banks were to run down their reserves to the mandatory 8% ratio with deposits. Even this theoretical maximum falls short of the 'normal' cumulative end December purchases of 250,000 tonnes or 65% of an estimated CEPA projected main crop of 382,000 tonnes.

The reports of cocoa not being purchased at all on credit confirm the fact that under the liquidity management approach that keeps the stock of Reserve Money strictly within the ESAF target regardless of the transactions demand for money, severe difficulties will arise even with the best efforts of BOG to ensure that any excess reserves of one group of banks could through the REPO be quickly transferred to deficit reserve banks.

It may be noted that the above discussion has only dealt with the question of cocoa purchases in 1999Q4 under the framework of strict liquidity management by BOG-interpreted set in the ESAF. Deposit draw downs by COCOBOD would also be for financing own operations as well as for payment of any cocoa export tax due to Government. Beyond the portfolio performances of the DMBs and the non-bank public may be the interest rate policy of the BOG. For example, sale of Tbills by DMBs may be constrained by BOG concerns about depressing prices of these bills that will result in rising yields (and interest rates). Relatedly, BOG may wish to restrain downward or depreciating pressure on the exchange rate and hence prefer that banks sold forex to the market.

The ESAF performance criteria

(i)	Change in NFA(BOG) in 1999Q4	=	\$319 m
	@ ₵3466.6 to \$1	=	₵1105.8 bn
(ii)	Ceiling for Reserve Money end 1999Q4	=	₵1583 bn
	Hence Change in Reserve Money	=	₵ 244 bn
(iii)	Assumed COCOBOD sale of forex to BOG in Q4	=	\$319m
(iv)	COCOBOD deposits at DMBs increase by ₵1105.8 bn		
	comprising of Demand Deposits	=	₵244 bn

The rest of the credit is held in the form of time deposits and some illiquid claims on the central bank and the Deposit Money Banks. Composition based on liquidity considerations to ensure that COCOBOD cannot write Akafo cheques in excess of ₵ 244bn which could reduce the reserves of DMBs below legal minimum cash reserves ratio of 0.08 (if banks fully loaned up).

Our supposition is that, on receiving the foreign loan for the COCOBOD the Bank of Ghana did not credit their local banks with the full cedi equivalent. The central bank must have released the credit to the local banks only in quotas that will not violate the Reserve benchmarks agreed to with the IMF. In the process the monies released for the COCOBOD to make its purchases could not cover all the purchases for the season. This unfortunate situation is one of the ways in which an undue focus on inflation can hurt the productive (real) sector.

The focus on inflation as the number one enemy to the exclusion of other economic targets conforms to the principle of “*inflation targeting*”. This form of inflation management is new in the literature but has been applied in certain advanced countries including New Zealand, Canada and Britain. Quite a number of the practising countries have registered success with inflation targeting. A number of studies, including one by some researchers at the IMF have concluded that inflation targeting may not be the right form of monetary management for developing countries. This conclusion was based on the fact that the prerequisites for inflation targeting are largely absent in developing economies.

An efficient inflation targeting framework requires

- (a) A central bank with some degree of independence, and
- (b) The willingness and ability of the monetary authorities not to target other indicators, such as wages, the level of employment, or the exchange rate.

In addition,

- (i) the monetary authorities must establish explicit quantitative targets for inflation for some periods ahead;
- (ii) they must indicate clearly and unambiguously to the public that hitting the inflation target takes precedence over all other objectives of monetary policy;
- (iii) they must set up a model or methodology for inflation forecasting that uses a

number of indicators containing information on future inflation;

(iv) they must devise a forward-looking operating procedure in which monetary instruments are adjusted to hit the chosen target; and

(v) the monetary authorities must have the technical and institutional capacity to model and forecast domestic inflation, know something about the time-lag between adjustment of the monetary instruments and their effects on the inflation rate, and have well-informed view of the relative effectiveness of the various instruments of monetary policy at their disposal.

Even if the central bank has the institutional capacity for inflation targeting is it able to neglect other targets, such as the exchange rate? How desirable is it for Ghana to achieve the lowest possible rate of inflation but end up with unemployment and recession? Is there an optimal rate of inflation taking into consideration seigniorage revenue and also short-run trade-offs between inflation and output? These questions must be fully deliberated on before setting inflation up as the one and sole target of monetary policy.

In its *Macroeconomic Review and Outlook for 1999*, CEPA had argued that the dishonouring of Government cheques by the Bank of Ghana may be worsening the arrears problem which may contribute to distress at the banks. Most Government projects are prefinanced by the banks; and hence the non-payment of the contractors and other suppliers of goods and services to government institutions may indirectly be leading to a pile-up of non-performing assets at the banks. For a development bank whose main customers are in the construction sector this may hurt its capital adequacy position. Recall that one of the main contributors to the East Asian financial debacle was the collapse of the real estate sector which led to the build-up of huge non-performing assets in their banking sector.

During the year under review, the Bank of Ghana continued to exercise supervisory powers over the financial sector. The Banking Law and the Exchange Control Act were enforced, almost to the letter. Circulars were sent to various banks reminding them of limits on their foreign exchange exposure. In addition, by the ESAF agreement signed with the IMF, the central bank agreed to close down any bank which fails to meet the capital adequacy ratios as of

the end of September 1999. It was, however, not until January 2000 that two banks were closed down, presumably, for not meeting the capital adequacy requirement.

5.2 Developments in Money

The restrictive policies of the Bank of Ghana was able to contain growth in the stock of Broad Money (M2+). Characteristically, the first quarter saw a decline in the money stock before rising slowly in the second and third quarters, ending the year with a 9.5 percent leap in the final quarter. Nevertheless, on the whole, the monetary authorities managed to contain growth in the money supply to only 16.1 percent, which was still lower than the 17.2 percent growth in the previous year and even better than the ESAF programmed target of 17 percent.

	Dec-98	Mar-99	Jun-99	Sept-99	Dec-99	Yr-on-Yr Growth %
Narrow Money (M1)	2069.9	1958.5	1970.2	1948.6	2129.4	2.9
Currency in circulation	1083.6	972.2	947.4	972.9	1186.1	9.5
Demand Deposits	986.3	986.3	1022.8	975.7	943.3	-4.4
<i>Quasi Money (QM)</i>	1161.4	1222.5	1305.1	1390.2	1433.6	23.4
Savings Deposits	672.3	712.1	774.9	792.3	876.1	30.3
Time Deposits	489.1	510.4	530.2	597.9	557.5	14.0
Broad Money Supply (M2)	3231.3	3181.0	3275.3	3338.8	3563.0	10.3
Foreign Currency Deposits	672.4	710.9	766.6	803.0	970.5	44.3
Broad Money Supply (M2+)	3903.7	3891.8	4041.9	4141.8	4533.5	16.1
Sources						
Net Foreign Assets	844.3	548.5	164.0	35.3	110.1	-87.0
NFA (BOG)	315.6	246.5	-59.2	-224.1	22.5	-92.9
NFA (DMBs)	528.7	302.0	223.2	259.4	87.6	-83.4
Net Domestic Assets	3059.4	3343.4	3877.9	4103.9	4423.4	44.6
<i>Net Domestic Credit</i>	2951.5	3296.3	3980.1	4352.6	4891.3	65.7
- Central Govt (net)	1118.2	1340.7	1768.2	1923.0	1978.0	76.9
- Cocoa Financing	47.9	28.4	10.5	8.2	69.9	45.9
- Other Public Sector	146.1	149.1	214.4	236.1	413.9	183.3
- Private Sector	1639.3	1778.1	1987.0	2185.2	2429.5	48.5

<i>Other Items (Net)</i>	107.9	47.1	-102.2	-248.7	-467.9	-533.6
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Source: Bank of Ghana Statistical Statements

The main element accounting for the slow growth in the money stock was a squeeze on demand deposits (-4.4%). The intense liquidity management through the use of **Repo** and swap arrangements effectively mopped up excess reserves from the banks and thus limited their credit creation activities. Further, the non-payment of Government cheques slowed down the circulation of credit in the economy. Of course this squeeze on credit directly affected investment in the real sector.

Although, Currency with the non-bank public increased slightly in the fourth quarter as has been the case in the past ending the year with a 3 percent increase over the December 1998 level, there was an unusual decline in December 1999. This may be the result of the non-payment of the cocoa farmers in the desire not to trip the reserves target within the ESAF. In any case, the squeeze on both liquid balances (demand deposits and cash) may have had a strong impact on transactions, which helped to moderate inflation.

Other components of the money stock, however, showed high growth rates: particularly, savings deposits (30.3%) and foreign currency deposits (44%). It is not quite clear what is driving up saving deposits. During the course of the year, the real rate of interest on savings turned positive when the rate of inflation fell below the nominal rate of interest on savings, and this may have induced some saving. But noting that the interest rate has not been a strong influence in the saving behaviour of the public, it is possible the majority of the public are simply not aware of any other forms of holding financial assets. With regard to the huge increase in the foreign currency deposits, the explanation may lie in the huge depreciation of the cedi towards the later part of the year. In the fourth quarter of 1999 alone, the change in foreign currency deposits was by 20.9 percent.

On the sources side, the policy of continuous intervention in the foreign exchange market devastated the Net Foreign Assets of the banking system which was already low by virtue of the slow down in foreign aid disbursement and the rising import cost of oil. For the year, the NFA

declined by 87 percent, compared to just about 6 percent decline in 1998.

The decline in the NFA was more that made-up for by the creation of Net Domestic Assets (NDA). The 44 percent expansion in the NDA would ordinarily have caused an expansion in the Reserve Money of the central bank and may have generated an inflationary push. However, the central bank cleverly mopped-up the excess liquidity that was injected into the banking system.

Developments in money in the fourth quarter were dictated by two main factors: (1) \$319 million credit received by the COCOBOD for crop purchases for the 1999/2000 season, and (2) limits imposed by the ESAF agreement the country signed with the IMF. This can be illustrated as follows:

At an average exchange rate of $\text{¢}3,466.60$ per dollar, the \$319 million loan translates into about 1,105.8 billion cedis, implying that the net foreign assets (NFA) of the central bank will increase by this amount. The central bank then had to create three offsetting liabilities to maintain its balance sheet identity; but this must be done keeping in mind limits imposed by the ESAF. In particular, the change in Reserve Money that is allowable in the fourth quarter under the ESAF was just 244 billion cedis. This means that the other liabilities to be created must be in the form of non-monetary claims and treasury bills. The changes in the central bank's balance sheet will look as follows:

Monetary liability in the form of DMB Reserves	=	244.0
Non-monetary claims of Cocobod on BOG	=	327.8
Claims by Govt on BOG through sale of T- bills	=	534.0
Total increase in cedi-based liabilities	=	1105.8
Total increase in cedi-based assets	=	1105.8

In other words,

$$\begin{aligned} _RM &= _NFA + _NDA + _G + _OIN \\ 244 &= 1105.8 + (-861.8) + (-534) + (-327.8) \end{aligned}$$

These changes will reflect in the accounts of the Deposit Money Banks (DMBs). On the asset side, the DMBs acquire ₵244bn in Reserves from the BOG (the allowable increase in Reserve Money); they also receive ₵534bn worth of Tbills. These total to ₵778bn of new assets. In addition, foreign-currency denominated claims of Cocobod on the DMBs amount to ₵245bn (or \$70.7m). Together these assets and liabilities amount to ₵533bn which is financed with new deposit liabilities of equivalent amount comprising ₵244bn of Demand deposits and ₵289bn of Savings and Time Deposits. Consequently the changes in the balance sheet of the DMBs will look as follows:

$$\begin{aligned} \text{DD} + \text{STD} = \text{Deposits} &= \text{Reserves} + \text{Tbills} + \text{Non-monetary illiquid claims on DMBS by Cocobod} = \text{NDA} + \text{NFA} \\ 244 + 289 &= 533 = 244 + 534 + (-245) = 533 + 0 \end{aligned}$$

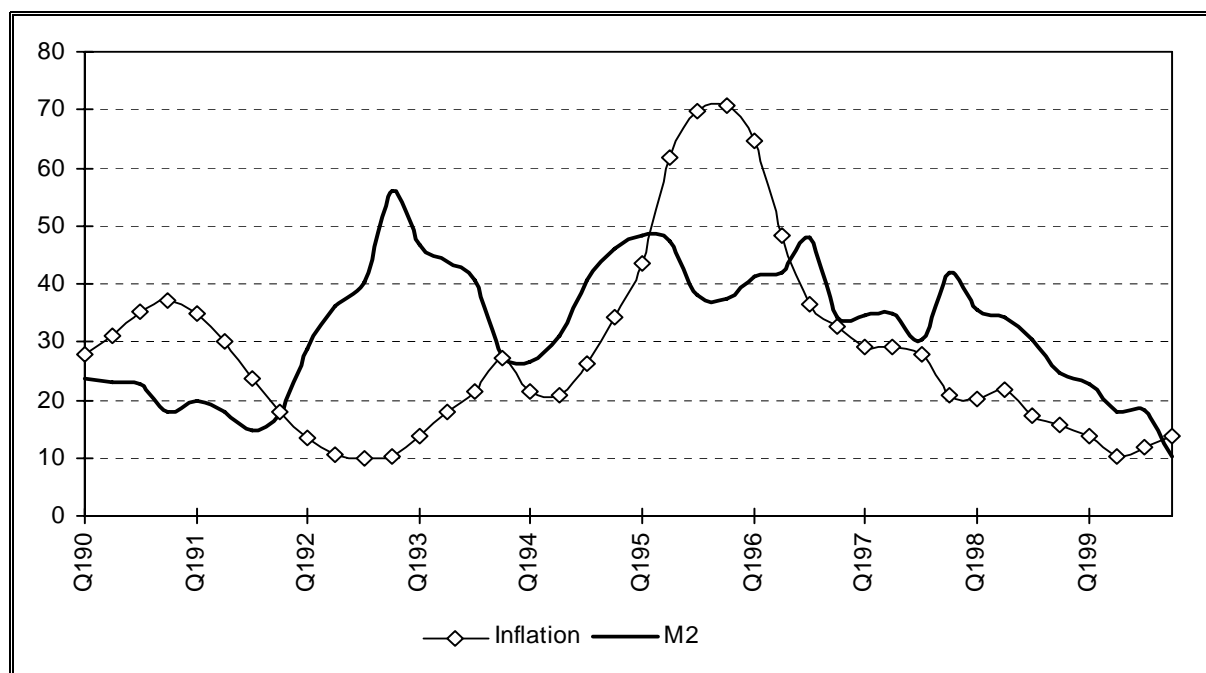
As of end-December, the targeted 237,000 tonnes of cocoa had been bought reducing the cedi-deposits to about the level of end-September. Meanwhile, the cedi value of the foreign-currency deposits rise from ₵827 billion at end-September to ₵1050 billion. The total deposits of the DMBS at the end of December equals ₵3594bn

ie. Cedi based deposits (end Sept value)	= 2544bn
Foreign currency based (\$value of Sept)	= 1050bn
Total deposits of DMBS	= 3594bn
Assuming the 11% reserve ratio is maintained, R _{Dec}	= 395bn

At the end of it all, the December 1999 figures from the Bank of Ghana's *Monthly Statistical Bulletin* shows that the central bank was able to stay within the Reserve limits imposed by the ESAF, using as definition of Reserve Money, the deposits of the DMBS at the central bank plus currency outside the banks. If, however, the cash-in-till of the DMBS is included in the definition as is normally the case, then Reserve Money limit would not have been met.

5.3 Developments in Prices

As suggested earlier in this report and in previous reports by CEPA, the main preoccupation of Government economic policy for the last couple of years has been with bringing the rate of inflation down. Available official data from the Ghana Statistical Service



shows continued declines in the rate of inflation. From an end of December 1998 rate of 15.7%, the year-on-year rate inflation declined continuously to a post-ERP low of 9.4% by May 1999. However, fiscal pressures could not allow the rate to stay at this long awaited single-digit zone for long. From June 1999 the rate rose slowly but steadily to an end year rate of 13.8 percent.

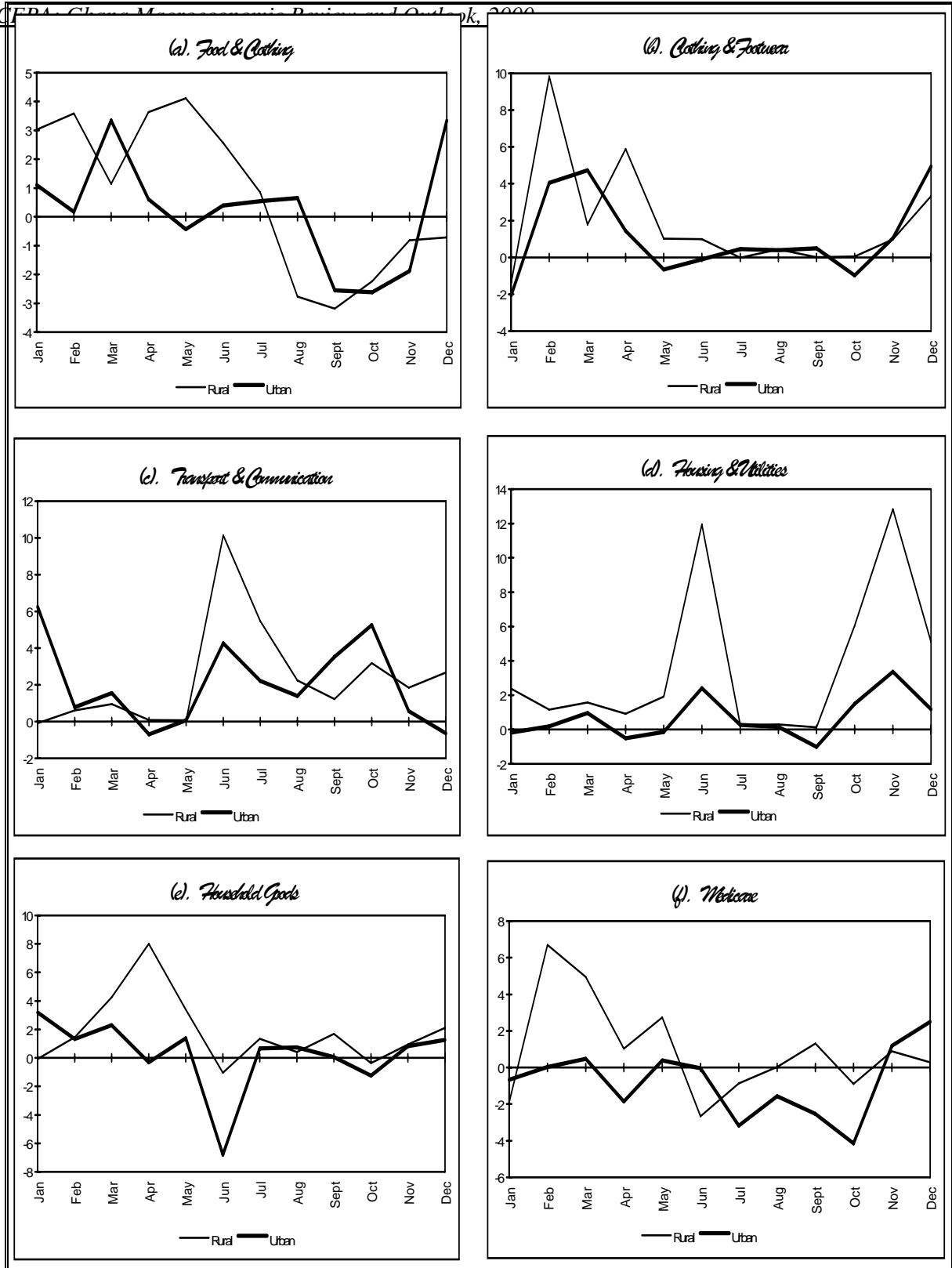
Figure 5.2 shows trends in inflation and the money supply. A cursory observation reveals a lagged response of inflation to changes in the money stock. Also very obvious is the three-year cycle of peaks and troughs that was discussed in the CEPA 1997 *Macroeconomic Review and Outlook*. In that *Review*, CEPA had expected the inflation trend to hit a trough between the second and third quarters of 1998 and commence a new cycle with an accent if the history had to be followed. Later developments showed a complete departure from past trends. Although there were statistical complications during the switch over from the old price series to the new one which did not lend credibility to the official inflation data, generally, one can conclude that the strict monetary policy paid off in prolonging the trough beyond 1997. Only a minor peak was

produced in the second quarter of 1998, followed by a steep decline in the rate of inflation to 9.4 percent at the end of May 1999. For the rest of 1999, inflation was on the rise. The question is whether the usual three-year cycle has just began. Can the central bank hold the rate down further by keeping the squeeze on money?

In terms of components, declines in food prices was as usual the main driving force behind the declines in inflation in Ghana. Food inflation declined from 21.8% in December 1998 to 12.4% by the first quarter and subsequently moved to single digits from May (3.8%) to December (6.6%). Whereas the rural food price index did not begin to fall until after the main harvest in July, the urban index had been on the decline since May 1999. It is possible that the urban sector benefitted from food imports brought in to avert the anticipated adverse supply situation occasioned by the draught of 1998. Nevertheless, the actual declines in food price indices between August and November can only be indicative of food glut which was never realized.

Some commentators have mistakenly assumed that because it is the food component of inflation which was largely responsible for the declines in the overall rate of inflation, therefore tight monetary policy and hence the central bank cannot be credited with the falling rates of inflation. The error is in assuming that money acts only on the non-food component of the inflation basket. A squeeze on the money supply acts through the transaction demand for real balances to affect the rate of change in the general price level. Thus, although the increase in food supply can bring down the rate of inflation, the central bank deserves commendation for muffling the demand-side pressures.

Month-by-month comparison of non-food inflation shows that, on the average, 1999 was worse 1999 than 1998. It is possible that the frequent increases in the price of fuel (four times in 1999) must have been responsible. But if this was the case, then both food and non-food components of the inflation basket would have been affected — the former through transportation. Interestingly, the cost of transportation rose more in the rural areas than in the urban areas. There are other interesting comparisons between urban and rural non-food price indices. For almost all the sub-components, non-food indices recorded higher growth rates in



the rural than in urban. For instance, the index for Education recorded a growth of 12% in the

rural compared to 7% for the urban and similarly for Medicare in which the rural index increased by 11 percent while the urban declined by 2 percent. In situations, where particular services commenced during the year such wide variations are possible; thus the wide differential between the Housing and Utilities indices for rural (21%) and urban (3%) in 1999 can be explained by the recent commissioning of rural electrification projects. The wide variations in the rural and urban sub-category indices are better seen in Figure 5.3. In almost all sub-categories the peaks in the rural indices are more pronounced than the urban.

5.4 Financial Market Developments

In April 1999, the Bank of Ghana lifted the embargo on the licensing of new banks by issuing new guidelines to be followed by institutions applying for licences. These new guidelines basically raised the initial paid up capital for the licensing of various financial institutions. The new paid-up capital requirements are as follows:

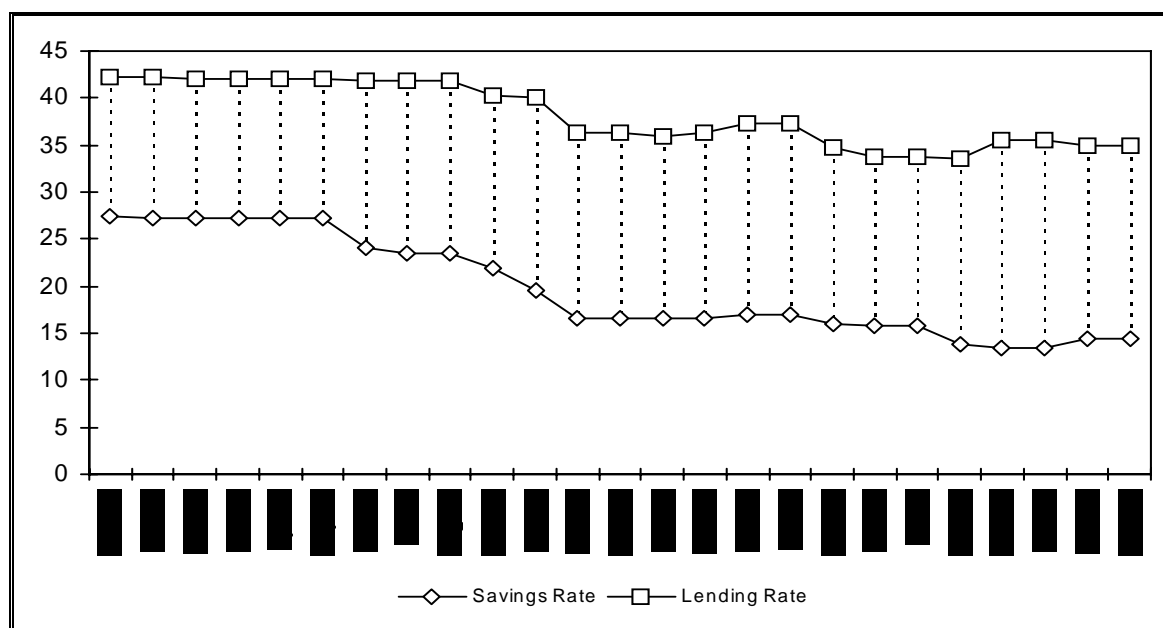
- a. Ghanaian bank should not be not less than ₵5 billion
- b. Foreign bank should not be less than ₵8 billion
- c. Development bank should not less than ₵10 billion
- d. Rural bank of should not be less than ₵100 million

Savings and Loans companies require paid-up capital of 1 billion cedis while other non-bank financial institution require ₵500 million. These increases in the paid-up capital of the financial institutions discouraged some local financial houses which were hoping to graduate to full-fledged banks. Nevertheless, by the close of the year two new banks had been issued with licenses to commence business bringing the number of DMBS to 19 by December 1999.

During the year there was intense marketing of banking services by the banks, particularly, the foreign-owned banks which appeared to be competing for quality customers. Both Barclays and Standard Chartered improved on their networking of branches to allow for improved service delivery, including telephone transactions. Other banks including the Ghana Commercial Bank also began the networking of some of their branches. The SSB Bank targeted workers on pay-roll. Several incentives were offered workers including lower initial deposit requirements and generous credit facilities.

On the other hand, some banks, particularly the foreign-owned banks, obviously looking for quality customers raised their minimum deposit requirements to 500,000 cedis. This is clearly higher than the average monthly earning in Ghana. In addition, these banks imposed some inexplicable charges on savers accounts. Depositors whose balance fall below 500,000 cedis are charged a “Savings Maintenance Fee” of 4,000 cedis a month! This reduces the service of the banks to that of safe-deposit units! Savers no more receive rewards for the use of their monies but rather are penalized. Although there is nothing wrong with a bank striving for quality customers, national policy must ensure some fairness in the financial market. The situation where foreign-owned banks are allowed to impose certain charges to discourage certain class of depositors while the local banks are expected, on purely nationalistic grounds, to service the poor end of the market must be seriously reviewed. The central bank or the Institute of Bankers must, as part of the ethics of their profession, have guidelines on charges to be imposed by the banks.

Another area worth examining also is the interest rate policy of the banks. Although the



financial market is supposed to be liberalized to the extent that banks are free to set their own rates, the structure of interest rates in Ghana does not show any competitive behaviour among the banks. With the connivance of the central bank, through the offer of high rates on Government paper and the maintenance high secondary reserve requirements, there was little incentive for banks to use interest rates as incentives in either their credit or borrowing services. Nevertheless,

in response to the drop in the rate of inflation and the declines in the treasury bill rates due to the slow down in the demand by Government for funds through the open market, the lending and saving rates were pressured down. From 37% in December 1998 the Bank rate was reduced to 32% in January 1999 and further to 27% in April. The 91-day Treasury bill rates also fell from 26.8% in December 1998 to 24.5% in April 1999. In consonance, the average savings deposit rates also fell from 16.5% in Dec.98 to 15.8% by June whilst the average lending rates declined from 40.5% to 37.3% in Mar. 99 and further down to 33.8% in June. The spread between the lending and the saving rates were maintained at over 20 percent.

Box 5b: New Requirements for Bank and Non-Bank Licences Issued in April 1999

1. Restricting Eligibility to Corporate Bodies

No person other than a body corporate incorporated in Ghana shall be eligible to apply for a licence to carry on the business of banking in Ghana.

2. No person(s) shall carry on the business of banking (whether as principal or agent) except by or under the authority of licence issued in accordance with this Act.

3. Application for Licence

(i) Every application for a licence shall be made in writing to the Central Bank and shall be accompanied by:

- (a) a certified true copy of the Regulations or other instruments, relating to the proposed business of banking, or by or under which any person proposing to carry on such business was established.
- (b) Names, addresses, occupations of persons who would hold significant share holdings directly or indirectly in the proposed banking venture and the respective values of such holdings as also their corporate affiliations.
- (c) Particulars of the directors or senior persons concerned with the management of the said banking business, including their background, financial position, business interests and performance of the business concerns under their control or management.
- (d) Feasibility reports including a business plan and financial projections for the first five years and areas of specialisation, if any, intended.

- (e) Capital and sources of funds; and
- (f) Such other particulars as the Central Bank may require.

(ii) The Central Bank may interview the promoter, directors and proposed senior management personnel in the course of appraisal and may also inspect their books and records to satisfy itself about the representations made or information furnished by the applicant.

4. 'In Principle' Approval

The Central Bank may issue 'in-principle' approval to the applicant on such terms and conditions as it may consider necessary and appropriate. If it is satisfied that

- (a) the applicant would carry on banking business with integrity, prudence and the required professional competence; and
- (b) the applicant has an initial paid-up capital that is required to hold a licence as follows:

Banks

- In case of Ghanaian bank, it is not less than 5 billion cedis.

-	In the case of a foreign bank, it is not less than 8 billion cedis brought into Ghana in equivalent convertible currency.
-	In the case of a development bank for medium or long term financing of agriculture or trade or industry, it is not less than 10 billion cedis and
-	In the case of a rural bank, it is not less than 100 million cedis.
Non-Bank Financial Institutions	
-	In the case of Savings and Loans Company, it is not less than 1 billion cedis.
-	In the case of Finance Company, it is not less than 500 million cedis.
-	All others --- 500 million cedis.
5.	Processing Fee
A non-refundable fee of 500,000 cedis (five hundred thousand cedis) shall accompany each application.	

5.5 *Developments on the Capital Market*

The performance of the Ghana Stock Exchange which earned it the best performing emerging market (International Federation of Stock Exchanges) and Africa's best performing market (Standard New York Securities Inc.), respectively, in 1998 slumped in 1999. The declining nature of the capital market throughout 1999 was evidenced by the continuous fall of the GSE All Share Index from 868.35 at the end of 1998 to 736.16 by close of 1999 indicating a 15 percent slump over the entire year. This compares poorly to a 69.7 percent growth in 1998.

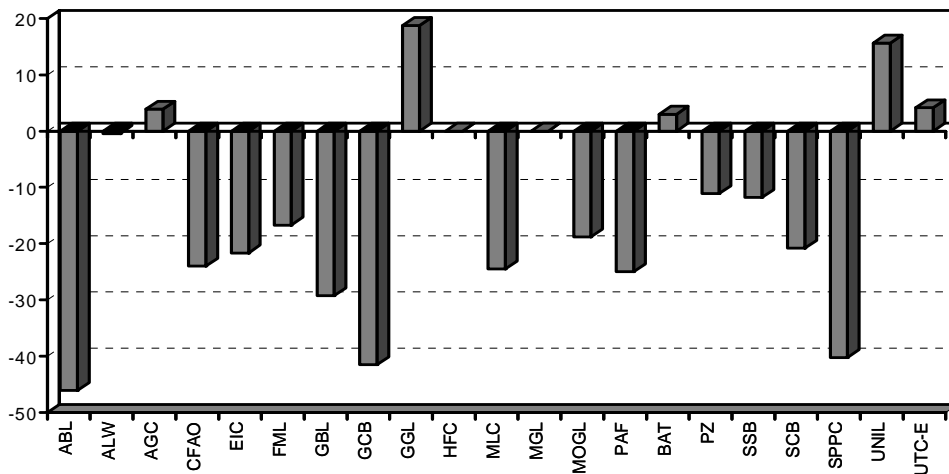
The dismal performance was attributed to downloading of shares by foreign investors who were cashing in on gains made in 1998, and low patronage from domestic investors. The main market mover, the Ashanti Goldfields Company recorded the lowest volume trading among the listed shares over the period. AGC's poor performance on the stock market could be attributed to falling gold prices on the world market in the first half of the year and the consequent financial turmoil that plagued the company in the second half. After successfully hedging against falling price of gold for several years, the fortunes turned against the AGC when very important players including the Bank of England and the International Monetary Fund decided they were no longer going to off-load their reserves on the market. This caused the price of gold to suddenly make an up-turn on the world market. This led to margin calls by Ashanti's creditors. The culminating pressure on Ashanti saw its share price on a downward slide and the company on the verge of a collapse. Temporary negotiations which were carried out including a possible meagre with Lonmin, the majority shareholder was abrogated following a veto by the Government of Ghana as the holder of the "golden share". Ashanti was temporarily saved from collapse when the gold

prices resumed their downward trend but Ashanti's woes were not over in 1999.

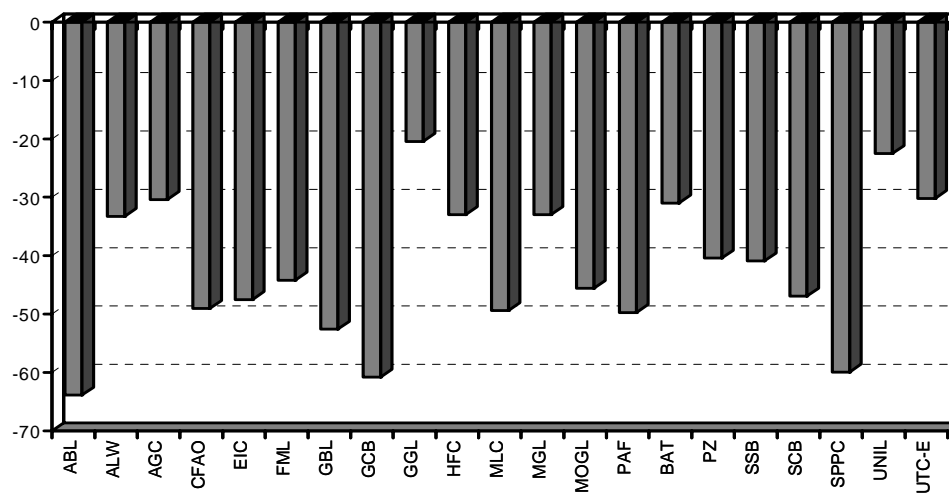
Although the AGC managed to insulate the Ghanaian shareholder from the fall in Ashanti shares on the international exchanges (AGC share price pegged at 18,700 cedis through out 1999), the poor developments in AGC filtered on the local Ghana Stock Exchange. The GSE simply refused to be moved – trading was not taking place. The selling pressure that prevailed throughout 1999 was evidenced by an average total volume of 2.4 million shares offered per trading session as against an average bid volume as low as 634,762 which results in an offer/bid ratio of 4:1 per trading session. This compares to an offer/bid ratio of 1:1.1 per trading session in the previous year. Overall, a total volume of 49.6 million shares valued at ₵69.6 billion was traded in 1999. This represents a 46 and 48 percent decline in both volume and value terms, respectively, when compared to 1998.

The declines in the Treasury bills rates over the period could not even push the stock market into action. The poor performance of the market resulted in huge capital losses for investors. Falling share prices resulted in a 1.2 percent decline in the market capitalization from ₵3,245.61 billion (US\$1.4 billion) in 1998 down to ₵3,205.39 billion (US\$1.2 billion) by close of 1999. Share price performances in 1999 contrasts sharply with 1998 where all except one of the companies registered capital gains with a third registering over 100 percent capital gain.

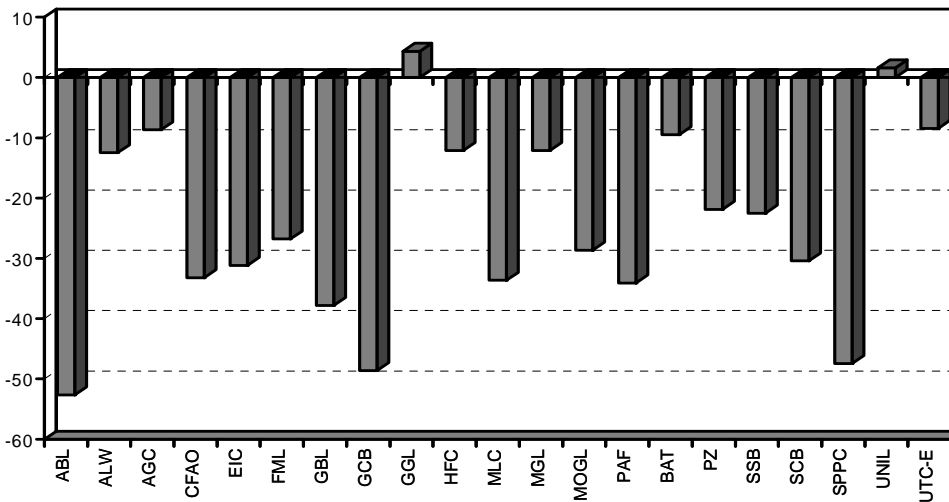
(a). Nominal Cedi Gains (+)/Losses (-)



(b). Nominal Dollar Gains (+)/Losses (-)



(c). Real Cedi Gains (+)/Losses (-)



Even though the half-year financial results released by the listed companies showed high turnover rates and impressive net after tax profits, it failed to turn around the slowdown in market activities. By end 1999, all except seven companies registered capital losses and the best company performer recorded a gain of only 18.8 percent. (see Figure 5.5a). In real terms only 2 companies had capital gains, while applying the appropriate exchange rates converts all the gains into losses in dollar-terms. Given that about 70 percent of investors on the GSE are foreigners the huge dollar losses had a negative influence on the market.

The GSE in 1999 welcomed a new listing, Camelot Ghana Ltd. which floated 1.75 million shares at ₵400 per share. The company which began as privately owned is in the printing industry. Through the offer, the company raised ₵700 million and was listed on the Stock market in September. The company became the first to be placed on the Second list of the GSE. By the stock exchanges' listing regulations, companies with a minimum stated capital of ₵100 million and at least five years of audited accounts qualify for the first list, those with ₵50 million stated capital and at least three years of audited accounts are placed on a second list and finally companies with one year of audited accounts and a minimum of ₵20 million capital are placed on a third list. By these categories, the stock exchange offers opportunities for companies with smaller stated capitals to get listed. Metalloplastica Ghana Ltd. offered a rights issue of 12 million shares and raised ₵2,160 million. In addition, the Home Finance Company issued a fourth public offer of its Housing bonds and raised an amount of US\$2 million. The bond (HFC Series D) is a five-year fixed rate note with interest payable half yearly at an interest rate of 8.25 percent per annum on the US Dollar denominated amounts. Through this offer the company hopes to raise funds for refinancing its US Dollar and Pounds Sterling denominated mortgages as well as fund other projected mortgages. This brought the total number of listed securities to 22 and 4 corporate bonds by the end of 1999. The public floatation of the Produce Buying Company Ltd. (PBC) will increase the number of companies listed to 23 in 2000.

In another development, the Bank of Ghana reminded the investing public regarding the transferability of original capital, dividends or interest payments and related earnings that BI application forms submitted through banks on behalf of shareholders in listed companies must be

accompanied by documentary evidence of (i) remittance of convertible foreign currency into Ghana (ii) conversion of the remittance into cedis at a local dealer bank (not forex bureau) and the cedi lodged into an account and (iii) settlement of shares acquired in cedis.

6. REVIEW OF TRADE AND PAYMENTS

6.0 Introduction

In 1998 Ghana experienced an export boom. Yet six months after the boom, Ghana was confronted with a foreign exchange crisis. The crisis manifested itself in a run-down of international reserves, lengthening queues for foreign exchange in the Deposit Money Banks (DMBs), increases in the premium on foreign exchange as parallel market operators gained in profitability, and a huge nominal depreciation of the cedi. By the end of 1999, the exchange rate had experienced its heaviest nominal depreciation since Ghana adopted the float in 1991, in spite of massive intervention by the Bank of Ghana. Consequently, gross reserves, in terms of months of imports cover, had fallen to their lowest ever.

The experience reveals in stark form, the fundamental vulnerability and fragility of a commodity-dependent economy. It also points to the need for a longer term perspective in the management of such an economy. The short-term management framework, with bursts of expenditures following export booms to be followed by impending crisis on the reverse side of the economic cycle the next year, is dangerous for such an economy. Furthermore, it reveals the dangers of using the exchange rate to achieve inflation targets in circumstances of weak and low international reserves position. The disincentive effect of such misaligned and artificially low exchange rates make the replenishment of reserves and the maintenance of the rate through exporting difficult, creating international aid dependence.

Aid dependence, delayed disbursements and program adjusters mean instability. Neither is the solution to be found in sudden and large nominal depreciations in one year to be followed by a reversion to using the exchange rate as an anchor against inflation. The evidence suggests that it is the maintenance of a stable real exchange rate that creates the relevant incentives for the traded goods sector. Such an economy cannot afford an overvalued exchange rate for a long period.

Smoothing over the medium-term would appear a more appropriate strategy and

management framework for such an economy. Generating the relevant social and political discipline to follow such a strategy would appear the bane of sustainable growth and development in Ghana.

6.1 The Foreign Exchange Market

As a result of the export boom in 1998, both government revenues and foreign exchange earnings increased substantially. Contrary to the expectation that substantial savings would accrue from these, both government expenditures and foreign exchange market intervention by the Central Bank increased substantially, leading to further real appreciation of the cedi- the cedi depreciated by 4 percent in nominal terms in 1998, all of it in the first half of the year. Maintaining the higher levels of expenditures and an appreciated real exchange rate after the boom created difficulties for the exchange rate and the balance of payments in the first half of 1999.

The level of external reserves fell to below two (2) months of imports cover by the end of the first half of 1999. This put strong depreciating pressure on the exchange rate. In addition, fears about the shortage of foreign exchange due to terms of trade shock and of resurgence in inflationary expectations compounded the pressure with possible speculative demand for foreign exchange. As discussed in the next section, even though world market prices for cocoa and gold dropped continuously in the first half of the year, because of the hedging activities of companies in cocoa marketing and gold mining, foreign exchange earnings nevertheless increased. However, the falling prices fuelled both inflationary expectations and fears of foreign exchange shortages.

Over the first half of 1999, the real exchange rate continued to appreciate as the nominal rate of depreciation followed the pattern of 1998. As the result of the boom in 1998, returns to holding foreign currency assets became less attractive relative to cedi-denominated assets. Also, as a result of the inflows, the Central Bank could afford to impose a 30 percent share limit on foreign currency deposits of the deposit money banks (DMBs). These developments discouraged foreign deposit mobilization and led to a movement from foreign currency denominated assets to cedi denominated assets, with consequent real appreciation. At the beginning of 1999, therefore,

expectations of a stable nominal exchange rate were high. These expectations, combined with the high returns to cedi-denominated assets, and also the enforcement of new exposure limits, moderated the rate of nominal depreciation.

As a result, for the first six months of 1999, the official nominal exchange rate (against the US dollar), depreciated by *7.8 percent and 7.1 percent in the interbank and forex bureaux markets respectively*. The real exchange rate therefore appreciated by between 3.2 percent to 4.4 percent between December 1998 and June 1999.

In the second half of the year, however, things changed dramatically. Expectations of higher inflation and shortage of foreign currency increased the demand for foreign currency, put pressure on the cedi resulting in nominal depreciation of *37 percent between end June 1999 and end December 1999*. By the end of the first half of 1999, the falling cocoa and gold prices had reached historical lows. At the same time the price of crude oil increased substantially from the US\$15.0 per barrel that had been used for Ghana's programming. These adverse terms of trade developments generated, in the first place, expectations of higher inflation. Falling cocoa and gold prices raised prospects that government revenue targets will not be met, with possible resort by Government to deficit financing with inflationary consequences. Rising crude oil prices in the world market started translating into higher domestic petroleum prices in April, causing increases in the level of the national consumer price index (CPI).

In the second place, adverse terms of trade combined with the profligacy of the previous year, generated actual shortages of foreign exchange and also increased expectations of foreign exchange shortages. Payments of deferred amortization from 1998 and increased import demand, created pressure on the low levels of reserves accumulated in 1998. These pressures were met by running down international reserves both at the Bank of Ghana and the DMBs. By the end of 1999, Ghana's gross international reserves could cover less than two months of imports. The resulting foreign exchange shortages caused a build-up of queues for foreign exchange in the banks. As the terms of trade deteriorated further, expectations about foreign exchange shortages compounded the actual shortages. These were worsened as the largest gold producer in the country, Ashanti Goldfields Company, run into trouble with its hedge book - prompting a substantial drop in the share value of the Company.

Table 6.1 : Nominal and Real Rates of Depreciation

	Nominal Rates of Depreciation (%)				Real Rates of Depreciation (%)	
	Interbank Market		Forex Bureaux Market		CPI-Based	Export Cost
	<i>End-Period</i>	<i>Average</i>	<i>End-Period</i>	<i>Average</i>	Index	Index
<i>Dec '90 - Mar '91</i>	3.20	4.14	8.55	7.96	(4.93)	(7.63)
<i>Dec '90-June '91</i>	4.72	6.23	9.03	8.82	(6.29)	(10.87)
<i>Dec '91 - Mar '92</i>	4.06	2.80	11.58	9.73	(1.36)	0.38
<i>Dec '91-June '92</i>	6.22	6.25	11.21	9.27	(0.97)	1.89
<i>Dec '92 - Mar '93</i>	15.66	15.72	14.82	14.80	2.91	(4.57)
<i>Dec '92-June '93</i>	15.66	15.80	18.76	17.11	(3.08)	(8.63)
<i>Dec '93 - Mar '94</i>	14.02	17.16	13.21	15.80	9.48	8.82
<i>Dec '93-June '94</i>	15.10	16.94	14.59	14.82	3.32	6.86
<i>Dec '94 - Mar '95</i>	5.54	3.67	7.50	6.86	(8.98)	(17.72)
<i>Dec '94-June '95</i>	11.52	10.87	12.43	11.98	(17.76)	(21.68)
<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>Dec '96 - Mar '97</i>	8.75	7.34	9.31	8.46	(2.36)	(6.39)
<i>Dec '96-June '97</i>	21.57	19.43	26.38	23.43	0.61	(5.78)
<i>Dec '97 - Mar '98</i>	2.48	2.68	2.63	4.05	(6.70)	(3.89)
<i>Dec '97-June '98</i>	3.23	3.18	3.07	4.74	(14.00)	(11.69)
<i>Dec '98 - Mar '99</i>	2.99	2.21	2.92	4.30	(4.56)	(2.52)
<i>Dec '98-June '99</i>	7.83	9.03	7.10	7.58	(4.36)	(3.24)
<i>Dec '98-Sept '99</i>	13.82	12.44	14.29	13.98	3.44	(0.59)

Dec '98-Dec '99	49.23	47.98	48.23	47.30	27.43	13.00
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Note : Estimates of the nominal rates of depreciation are based on the 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.

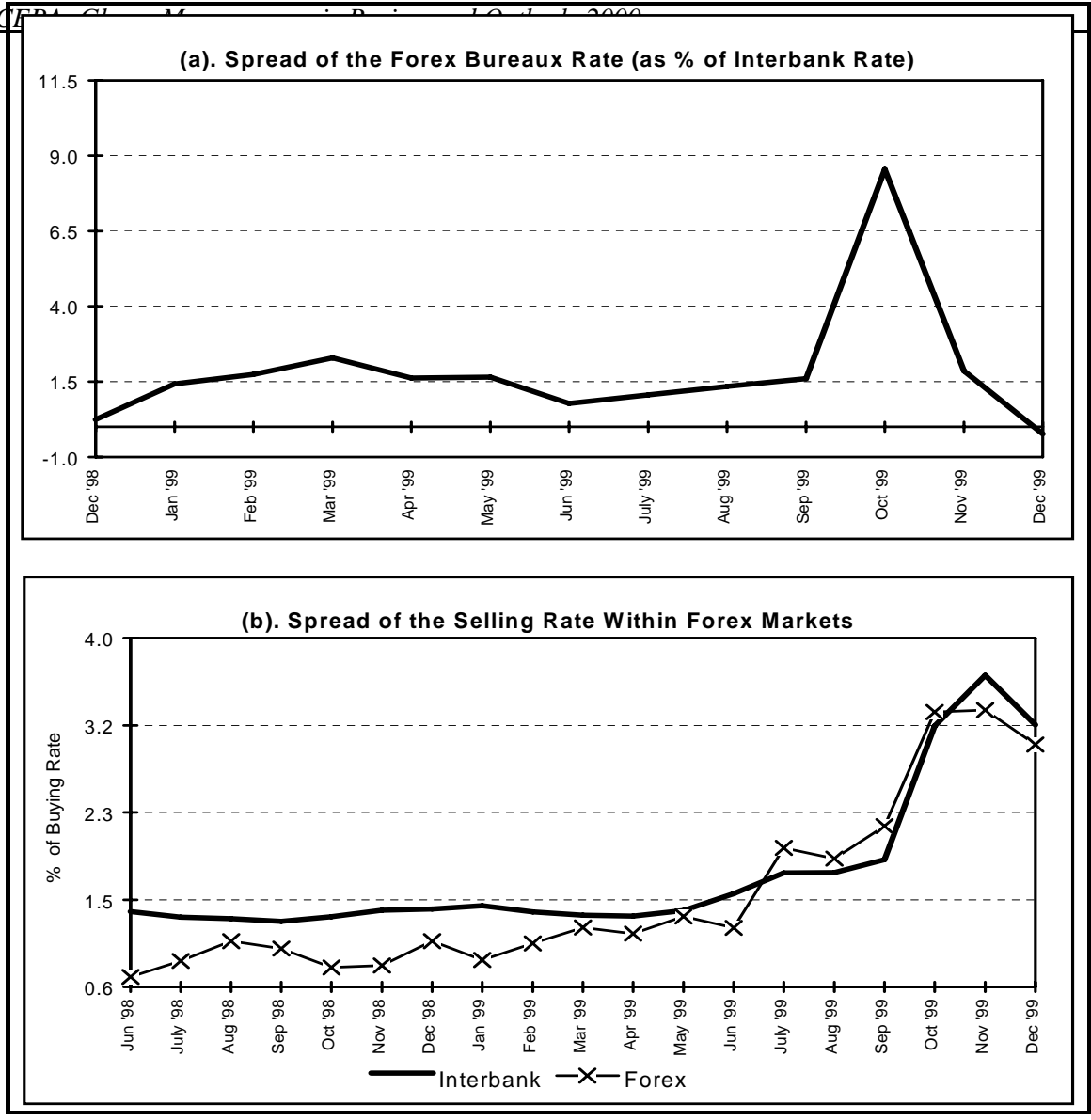
Source: Bank of Ghana

As a result of these developments, the cedi depreciated by 48 percent in nominal terms for the year 1999. On a December to December basis, this is the highest one year depreciation recorded in the last decade, except for 1993. This contrasts sharply with the 4 percent recorded for 1998 which was the lowest nominal depreciation since the ERP in 1983. Such wide variations in the rate of depreciation reflect a short-term year-to-year management framework instead of a long-term perspective that will foster a more stable rate of depreciation. Wide variations in exchange rate depreciations tend to have adverse effects on business expectations and planning.

For the first time in the last five years, the real exchange rate depreciated by 27 percent on the basis of official CPI data and 13 percent on the basis of exporters' costs index. The difference reflects the much faster increases in the prices of non-traded goods affecting the profitability of exporting, such as electricity, water and transportation (see Table 6.1).

The spread between the buying and selling rates, which reflect in part the premium on foreign exchange, was similar to the pattern in previous years for the first half year. It averaged about 1.3 percent. However, as the foreign exchange shortage intensified in the second half of the year and queues built up, the difference between the two rates increased to above 3 percent in the last quarter in both the interbank and forex bureaux markets (see Panel (b) of Figure 6.1). This spread also reflects the downward stickiness of the selling rate.

The spread in the exchange rates between the interbank and forex bureaux markets (see Panel (a) of Figure 6.1) reflect both the differences in trading instruments as well as the degree of or lack of integration of the two markets. This indicator increased throughout the year, reaching a peak of 8.5 percent in October 1999 before declining to *negative* 0.23 percent in December 1999.



The spreads discussed above could incorporate elements of inefficiencies in the markets as well as their segmentation. They indicate a need to address these long-standing problems and improve the competitiveness of the two markets.

Generally speaking, there has been a high and rising overvaluation of the cedi - reclining, on a PPP basis, almost 40 percent by the end of the first half of 1999. Everything else the same, an overvaluation in excess of 25 percent is judged excessive and likely to herald an imminent currency crisis. Thus, in the face of the severe terms of trade changes that impacted sharply in the third quarter and the delays and cancellation in aid disbursements, a technical correction got underway in September. On the basis of the official inflation data, that correction was completed by the end

of the year.

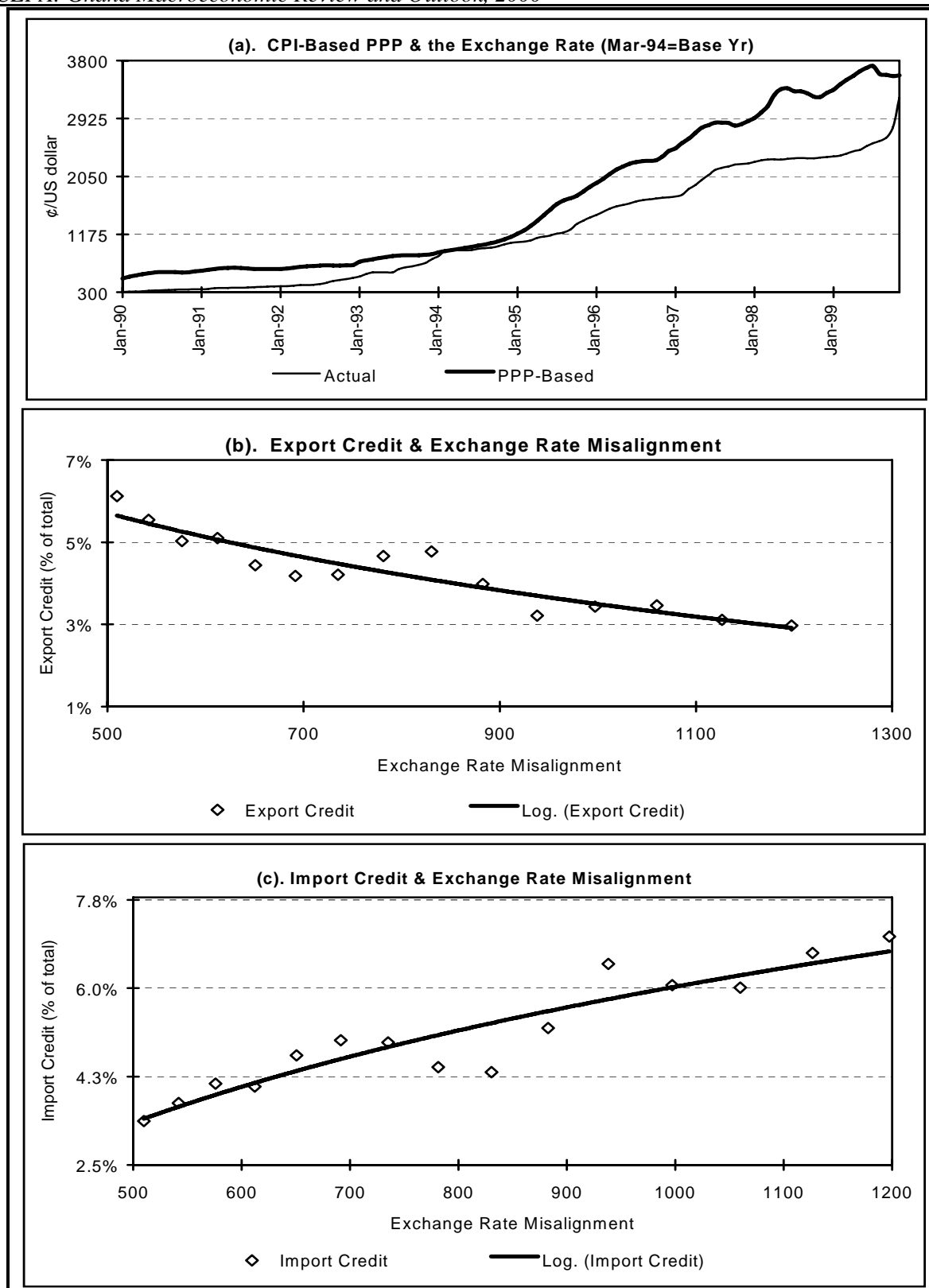
As often happens, there was a Dornbusch-style overshooting, especially in the forex bureaux market where the exchange rate reached ₵4,000 per US dollar. Indeed, even the official rate now being calculated by the Bank of Ghana on transactions, not indicative rates posted by banks, showed a mild (0.7 percent) over-depreciation.

	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>Q199</i>	<i>Q299</i>	<i>Q499</i>
1). Extent of Overvaluation (%)	33.1	21.7	34.0	38.8	39.5	(0.6)
2). Trade Balance (=deficit) US\$ million	(295.2)	(638.4)	(532.8)	(108.6)	(260.2)	(710.4)
3). Current Account (excl. Official Transfers)	(457.7)	(709.5)	(580.0)	(117.7)	(281.9)	(712.8)
4). Gross International Reserves (US\$ million)	598.8	508.5	507.7	452.4	363.7	420.1
5). Terms of Trade Changes	(3.3)	(0.7)	26.5	-	-	(3.2)
Memorandum Item						
Overall Balance of Payments (US\$ mill.)	220.3	(7.8)	33.7	(153.5)	(305.6)	(304.8)

Notes : 1/. Table is constructed on the basis of data provided in editions of the Quarterly Economic Bulletin (Bank of Ghana)
2/. There are serious problems with the external accounts data for 1997. An abnormally large current account deficit was financed with large medium-term non-concessional loans. In addition, the errors and omissions item in other capital was exceptionally large - implying an unidentified source of large capital inflows. It is consequently best to set 1997 aside.

Ghana had stored up external payments problems by continuously subsidizing the consumption of imports through the overvaluation of the currency. Using PPP and 1994 as the base, the real exchange rate appreciated throughout the period to unacceptable levels. Figure 6.2 shows the disparity between the actual and PPP rates throughout the period of investigation, the first quarter of 1995 through the third quarter of 1999.

Table 6.2 indicates that by the second half of 1999, the real exchange rate was 39 percent below the PPP rate. This was in spite of the general acceptance that Ghana was facing unfavourable external terms of trade requiring both adjustment and financing since this shock could not be treated as temporary. Anticipating the adverse impact of the shock on the economy and preparing the necessary adjustment was ignored in favour of a crude monetarist management in which foreign exchange operations were used as contractionary monetary policy by running



down reserves. It was clear that this could not be sustained and that as reserves run down and the foreign exchange shortage intensified the currency would have to depreciate.

The difficulties of 1999 aside, it is increasingly clear that the inappropriateness of exchange rate policy over the last six years had weakened the fundamental basis of Ghana's development strategy — export-led growth strategy. The incentive to export had declined and the tendency to import increased with overvaluation of the currency.

The second and third panels of Figure 6.2 relate bank credit to the exports and imports sectors to the extent of overvaluation of the currency. It is easy to see that as the currency gets overvalued, banks are reluctant to lend to exporting firms but eager to embrace lending for imports. Thus, credits to exports as a percentage of total credit by the banking system is negatively correlated with overvaluation of the currency. On the other hand, credits to finance imports is positively correlated with overvaluation of the currency. Ghana cannot afford this kind of scenario. Neither can it afford a situation in which the exchange rate is one of the tools in some crude financial management programme aimed solely at inflation to the neglect of the growth and employment trade-offs. Growth is the basis of poverty alleviation in Ghana's current development strategy.

6.2 *The Balance of Payments*

Preliminary estimates show that by the end of the first half of 1999, Ghana's external payments position had deteriorated to crisis proportions. A huge deficit of US\$157.7 million had occurred in the balance of payments, using the strict official settlements definition. If one includes the loss of foreign assets of the DMBs, the deficit rises to US\$305.6 million. Sluggish export growth of 4.2 percent, increased imports and dismal capital accounts inflows were responsible. Data from the Ghana Export Promotion Council and CEPA analysis show that this growth in export earnings is marginal measured against a rise of 18.5 percent recorded in the first half of 1998 relative to the same period in 1997. In spite of the significant growth differences, however, very little seems to have changed in terms of the commodity composition of the country's exports, as cocoa and gold continued to dominate export earnings. On their part, the shares of timber and non-traditional exports earnings in the total remained virtually unchanged in 1999 as the year before.

Table 6.3 : Balance of Payments Account, 1997-99 (US\$ million)

	<i>First Half</i>	<i>Full Year</i>	<i>First Half</i>	<i>Full Year</i>	<i>First Half</i>	<i>Full Year</i>
	<i>1997</i>	<i>1997</i>	<i>1998</i>	<i>1998</i>	<i>1999</i>	<i>1999</i>
Merchandise Exports (fob)	739.3	1,489.9	875.7	1,813.2	912.3	1,879.6
Gold	282.6	558.5	318.3	687.8	324.1	711.0
Cocoa Beans and Products	256.2	470.0	327.3	628.6	355.1	541.0
Timber & Wood Products	79.9	172.0	83.6	170.2	87.4	174.0
Others (n.e.c.)	120.6	289.4	146.5	326.6	145.7	453.6
<i>of which</i> Non-Traditional Exports	69.4	188.5	129.1	242.6	126.1	-
Imports (fob)	1,055.9	2,128.3	1,161.6	2,346.0	1,172.5	2,590.0
Oil Imports	128.4	233.9	143.3	221.1	104.1	323.0
Non-Oil Imports	927.5	1,894.4	1,018.3	2,124.9	1,068.4	2,267.0
Trade Balance	(316.6)	(638.4)	(285.9)	(532.8)	(260.2)	(710.4)
Services (net)	(149.7)	(471.4)	(169.9)	(501.0)	(173.9)	(474.4)
<i>of which</i> Interest Payments	(60.0)	(130.1)	(71.6)	(153.1)	(66.4)	(125.0)
Tourism	63.8	127.7	71.0	142.0	90.0	154.0
Other Services	(153.5)	(469.0)	(169.3)	(489.9)	(197.5)	(503.4)
Private Transfers (net)	153.8	400.3	164.2	453.8	152.2	472.0
Current Account Balance (CAB)	(312.5)	(709.5)	(291.6)	(580.0)	(281.9)	(712.8)
Official Transfers (net)	60.6	159.7	57.5	230.1	110.0	239.7
<i>of which</i> Project Grants	36.4	96.0	40.5	162.0	80.0	160.0
Program Grants	11.8	31.0	10.5	42.0	17.6	35.0
Other	12.4	32.7	6.5	26.1	12.4	44.7
CAB (including official transfers)	(251.9)	(549.8)	(234.1)	(349.9)	(171.9)	(473.1)
Capital Account Balance	145.5	492.7	194.7	358.9	(133.7)	168.3
Official Long/Medium (net)	215.6	499.3	174.5	317.7	-	-
Private Long/Medium (net)	84.3	55.4	42.4	76.9	-	-
Short-term (net)	(154.4)	(62.0)	(39.8)	(35.7)	-	-
Errors and Omissions	-	122.2	(9.4)	90.3	-	-
Overall Balance	(106.4)	(7.8)	(48.9)	33.7	(305.6)	(304.8)
Bank of Ghana (dnFA)	(104.3)	24.9	22.3	99.4	(157.7)	(93.4)
Deposit Money Banks (dnFA)	(2.1)	(32.6)	(71.2)	(65.7)	(147.9)	(211.4)
Memorandum Items						

Average Exchange Rate (¢/US\$)	1,800.9	2,050.3	2,252.2	2,314.2	2,372.8	2,647.3
Gross International Reserves						
End of Period (US\$ millions)	482.7	508.5	438.6	507.7	363.6	420.1
Equivalent months of Imports (cif)	2.5	2.6	2.1	2.4	1.7	1.8
Non-Oil Imports (cif) - (US\$ millions)	1,004.9	2,052.4	1,103.2	2,302.1	1,157.5	3,446.6
Gross Domestic Product (US\$ million)	7,027.5	6,890.8	7,198.2	7,821.3	8,649.9	8,289.1
Percent of Gross Domestic Product						
Current Account Deficit (incl. Off. Transfers)	(3.6)	(8.0)	(3.3)	(4.5)	(2.0)	(5.7)
Current Account Deficit (excl. Off. Transfers)	(4.4)	(10.3)	(4.1)	(7.4)	(3.3)	(8.6)
Trade Balance	(4.5)	(9.3)	(3.9)	(6.8)	(3.1)	(8.5)
Merchandise Exports (f.o.b.)	10.5	21.6	12.2	23.2	10.5	22.7
Merchandise Imports (f.o.b.)	15.0	30.9	16.1	30.0	13.6	31.2

Notes

- 1/. Exports data was sourced from MOTI, Bank of Ghana, GEPC, Chamber of Mines, and Forests Products Inspection Bureau.
First Half Year data for 1999 on non-traditional and other exports are CEPA Staff estimates.
- 2/. Non-Oil imports for the first half of 1999 are based on the cif data from CEPS, reflecting only the first five months, January-May. US\$180 million was added on for June, the same value as in May. The fob value was obtained using the appropriate factor. Oil imports were taken directly from MOTI

While the volume of Ghana's main exports, cocoa and gold, increased by 13.6 percent and 10.0 percent respectively over the same period in 1998, prices realized for cocoa and gold were mixed. Cocoa prices realized by Ghana increased by about 5.0 percent from a weighted average of US\$1647 per metric tonne in the first half of 1998 to US\$1726 per metric tonne in the first half of 1999. In the case of gold, average prices declined by 8 percent from a weighted average of US\$308 per fine ounce in the first half of 1998, to US\$283 per fine ounce in the first half of 1999. These developments resulted in only 2 percent and 8 percent growth in the value of gold and cocoa exports respectively.

Sluggish export growth, combined with continuing high import demand resulted in a worsening of both the trade and current account deficits. Ghana's trade deficit increased from US\$532.8 million in 1998 to US\$710.4 million in 1999. This represented an increase in the deficit from 6.8 percent of GDP in 1998 to 8.5 percent of GDP in 1999. The current account deficit (including official transfers) increased from 4.5 percent of GDP in 1998 to 5.7 percent of GDP in 1999. The current account deficit is twice the level of sustainable deficit of 3 percent from CEPA's analysis.

Compounded by insufficient capital inflows, both on account of poor divestiture receipts and public sector loan disbursements, the overall balance recorded one of its highest deficits in more recent times.

In the second half of the year, there were improvements in donor disbursements but the exchange rate depreciated sharply, especially in the fourth quarter which helped to hold imports growth down. In spite of these, the net foreign assets and gross international reserves position of the Central Bank continued to deteriorate sharply in the third quarter of the year. Some relief was obtained from a short-term cocoa financing loan of US\$350 million. Even this was insufficient to reverse the deterioration in the balance of payments. On a cumulative basis, the deterioration in the net foreign assets of the Bank of Ghana amounted to US\$269 million. This implied that to achieve the ESAF target of an increase of US\$50 million for the year, a build-up of US\$319 million was needed in the fourth quarter. The overall balance, therefore, deteriorated from a surplus of US\$99.3 million in December 1998 to a deficit of over US\$93 million in December 1999, using the official settlements definition. Broadening to include changes in the net foreign assets of the DMBs, the overall balance of payments deficit was US\$304.8 million.

The partial recovery in the Asian economies, the woes of the only African multinational company - Ashanti Goldfields Company, and fears of a technical correction for the overvalued currency from the beginning of the year, reduced the attractiveness of the Ghanaian market for foreign investors.

6.3 Trends in Exports

Growth in earnings from gold exports in 1999, was not altogether expected to be substantial. If anything, CEPA had anticipated in its *Macroeconomic Review and Program for 1999* a 2.0 percent decline in gold export earnings on account of a projected 2.8 percent fall in world market prices. In spite of an unexpected and sharp fall in gold prices on the world bullion market, receipts in gold exports *increased* by 1.6 percent from US\$687.8 million in 1998 to US\$711.0 million at the end of 1999.

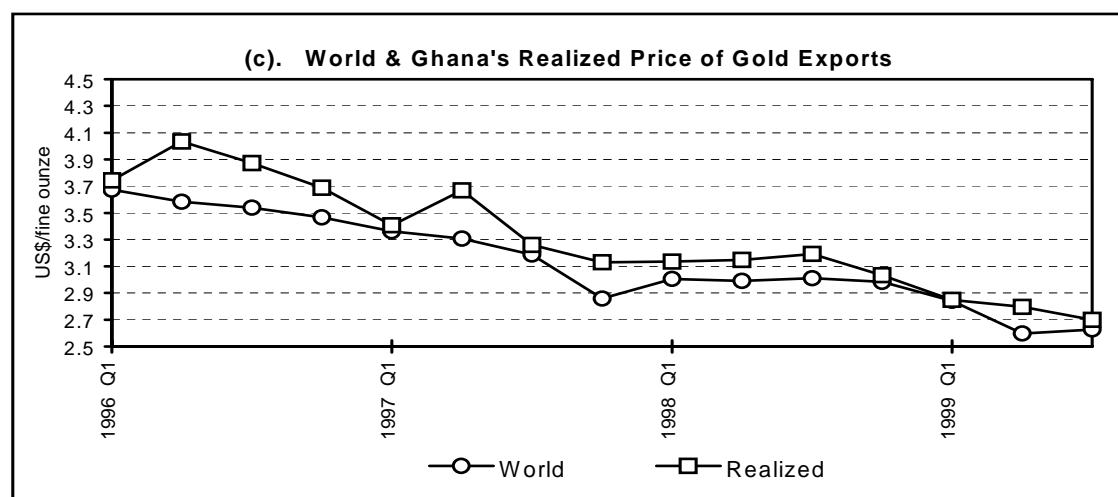
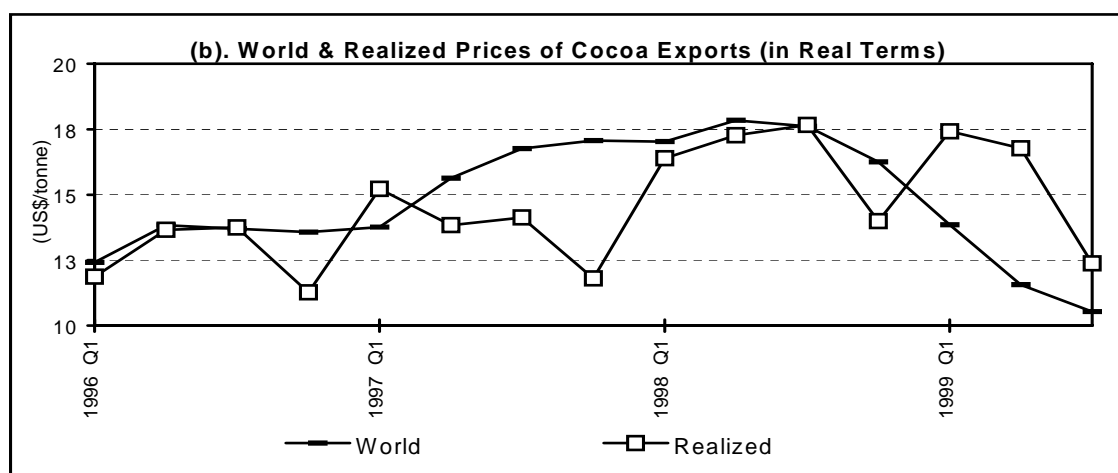
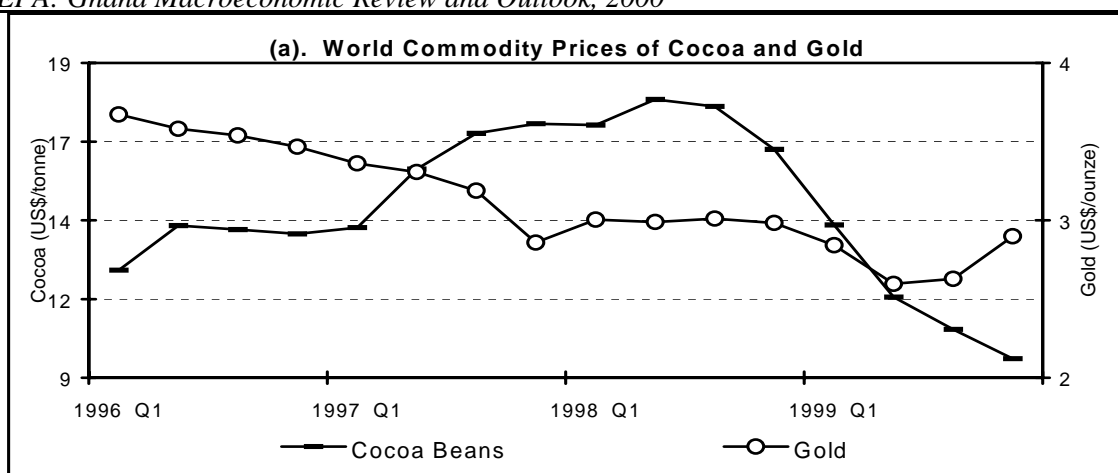
It is worth recalling that earlier in 1999, the IMF decided to sell a tenth of its gold reserves to finance its share of the debt relief initiative for Heavily Indebted Poor Countries (HIPC). In addition, the Bank of England also announced its intention to follow other central banks in Western Europe to auction 415 metric tonnes of gold, since gold's allure as an inflation-proof asset turned out to be less lustrous, especially at a time when inflation risks in Western European economies seemed to have fallen. These decisions sharply pushed downwards the price of gold by 10.4 percent (from US\$292 per fine ounce in December 1998 to US\$261 per fine ounce at the end of June 1999 - its lowest level in 20 years).

Over the second half of the year, however, gold prices staged a rally largely on account of determined lobbying by the World Gold Council (including arguments about how much a low gold price hurts poor producer countries) and the IMF's cancellation of its own gold sales following increased pressure from the American Congress. Gold prices thus closed at US\$293 per fine ounce at the end of December last year (see Figure 6.3)¹².

Cocoa prices also languished at historical lows since the beginning of the year. On the New York Cocoa Exchange, for example, prices started a steady downward slide from US\$1392 per metric tonne in January 1999 to as low as US\$960 per metric tonne in mid-May. A slight recovery in the price was experienced after that, closing at US\$1163 per metric tonne by the end of the second quarter of 1999. This proved to be short-lived, however, as the price plummeted to US\$971 million at the close of the year. As in the case of gold, CEPA had anticipated a 5 percent decline in cocoa prices which was expected to reach US\$1500 per metric tonne by the end of the year. Given the continuing price declines in international markets, the CEPA estimate proved over-optimistic. Notwithstanding the declining prices of gold and cocoa on international markets, however, export receipts increased in the first half year relative to the same period in 1998. Over the entire year, however, export receipts from cocoa fell by almost US\$38 million (0.5 percent of GDP) from US\$628.6 million in 1998 to US\$541 million in 1999.

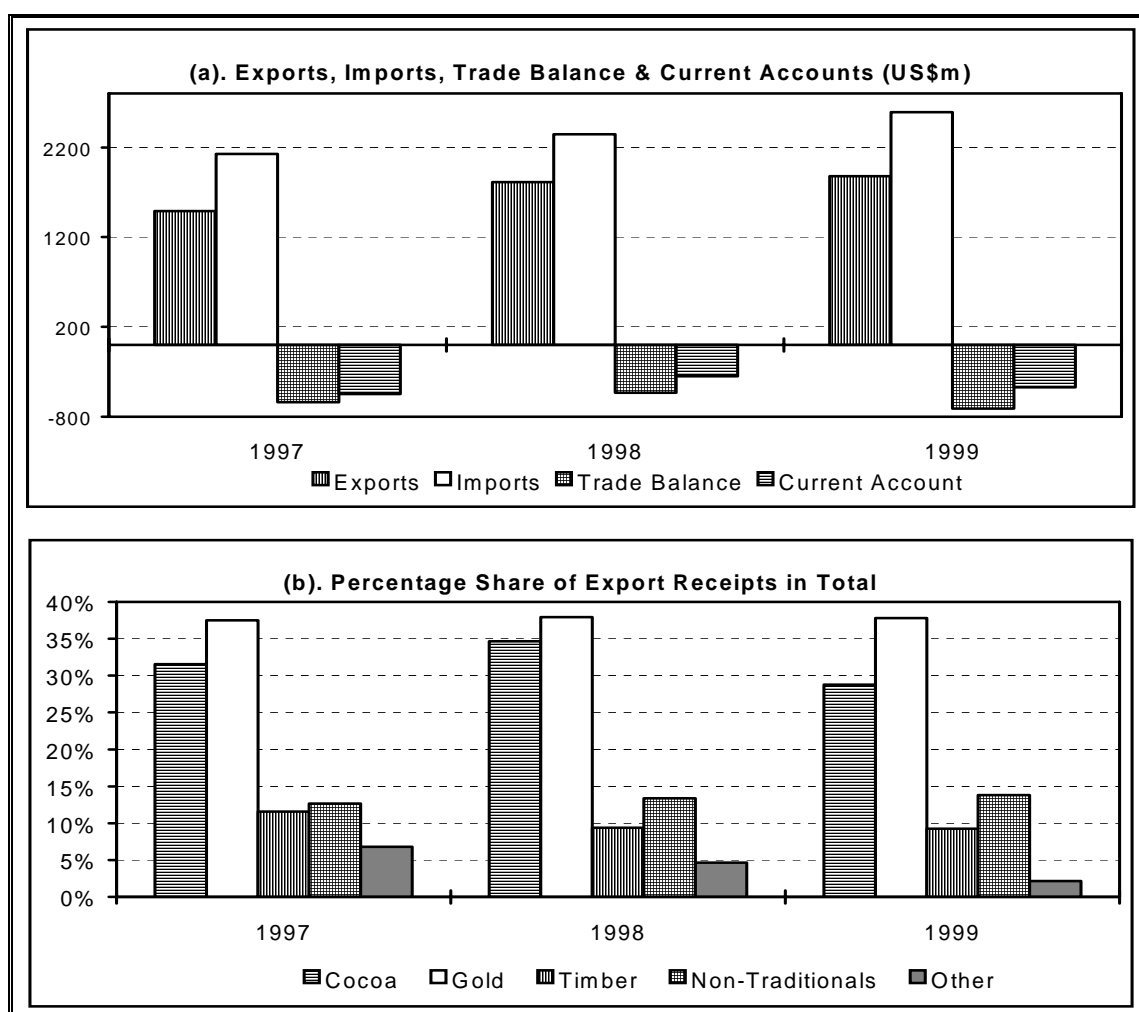
¹² Commodity prices have been deflated by the unit export index of industrial countries - the destination of Ghana's major exports. All data were taken from monthly editions of the *International Financial Statistics* (IMF, Washington D.C.). The y-axes of the chart in Panel (a) of this Figure have been differently scaled. The realized prices are the implicit prices, taking account of the volume of Ghanaian exports.

The rather disappointing price developments on world commodity markets during the year, bring to the fore the issue of the vulnerability of an economy that continues to be highly dependent on resource-based products for her exports. As noted in earlier CEPA reports, effective management of an economy tied basically to non-oil primary commodities must take a longer-term perspective, as export revenues in the short-term typically remain vulnerable to fluctuations in international market prices and domestic production conditions. The challenge for sustainable development requires further diversification and more rapid development of non-traditional exports including tourism.



Ironically, the performance of non-traditional exports has been far less satisfactory - a situation attributable to the continuous real appreciation of the exchange rate and lax marketing strategies. Over the first half year, receipts from non-traditional exports (defined to exclude cocoa and wood products, but to include mineral ore exports other than gold) fell from US\$129.1

million in the first half of 1998 to US\$126.1 million at the end of the same period in 1999. The result has been that the contribution of non-traditional exports to total export earnings declined from 14.7 percent the previous year to 13.8 percent in 1999.



Apart from non-traditional exports, performance of timber and wood products on the one hand, and *other mineral ore exports* (notably, *diamonds, bauxite and manganese*) on the other, has been unimpressive. The contribution of these to total export receipts in 1999, declined slightly compared with their contribution in 1998 (see Panel (b) of Figure 6.4).

Total receipts from the shipment of timber and wood products increased by 2.2 percent in 1999 relative to 1998, the bulk of this increase coming from the shipment of almost 260 thousand

cubic metres of mainly kiln dried lumber. The performance of all mineral ore exports other than gold has been least impressive, as these export commodities continue to show little variability in their relative contributions to overall export earnings during the first half of 1999. The evidence is that their consolidated share in total export revenues fell drastically from about 6 percent in 1998 to less than 3 percent in 1999 (see Panel (b) of Figure 6.3).

6.4 Trends in Imports

Concerns have been raised in recent times about the very serious problems of reconciliation with the different sources of Ghana's imports data. In particular, not only is there a discrepancy between the imports data obtained from the Automated System of Customs Data (ASYCUDA) and those from Customs, Excise and Preventive Services (CEPS), but more worrisome is the fact that these different sources provide no detailed breakdown of the imports data. In the absence of detailed data on the composition, one can only comment on the overall trends.

The country's imports increased by 10.4 percent from US\$2346 million in 1998 to US\$2590 million in 1999. This relatively high growth rate compares with that of the previous year (10.2 percent), but lower than the 14.8 percent growth registered in 1996.

The growth in merchandise imports in 1999 was partly the result of continued real appreciation of the exchange rate especially over the first half of the year, and increased demand for crude oil, even as the average world market price more than doubled from US\$10.41 per barrel in December 1998 to US\$25.10 per barrel in December 1999. An examination of the data shows that whereas the non-oil imports bill rose by 6.7 percent, the oil imports bill rose by as much as 46 percent, reversing two years of declining oil imports.

As indicated in Table 6.4, oil imports accounted for 12.5 percent of total imports in 1999 compared with 11 percent and 9.4 percent in 1997 and 1998 respectively. At the same time, the share of non-oil imports in the total declined from 90.6 percent in 1998 to 87.5 percent, having increased sharply in 1996.

There are indications that large volumes of crude oil may have been imported into the country especially over the second half of the year. The evidence is that in the first half year of 1999, the oil imports bill fell by 27.4 percent (see Table 6.3). This fall was principally due to adjustment in demand after the energy crisis of 1998 that necessitated substantial imports of fuel for generating thermal electricity. The reduced volumes, even with sharp price hikes of oil, was thus responsible for US\$40 million decline in the import bill. Almost US\$219 million was expended on crude oil imports in the second half of the year. At prevailing average spot prices, the 46 percent growth in expenditure on oil imports in 1999 as a whole corresponds to about 6.0 percent growth in volume of crude oil imports, implying an income elasticity of demand of 1.5.

	<i>Average</i>					<i>Average</i>
	<i>1992-96</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>1996-99</i>
Imports f.o.b. (US\$ millions)	1,677.8	1,937.0	2,128.3	2,346.0	2,590.0	2,250.3
<i>Non-Oil Imports</i>	1,491.4	1,677.9	1,894.4	2,124.9	2,267.0	1,991.1
<i>Oil Imports</i>	186.5	259.1	233.9	221.1	323.0	259.3
Growth Rates						
Imports f.o.b.	8.4%	14.8%	9.9%	10.2%	10.4%	11.3%
<i>Non-Oil Imports</i>	8.3%	12.1%	12.9%	12.2%	6.7%	11.0%
<i>Oil Imports</i>	10.3%	35.7%	-9.7%	-5.5%	46.1%	16.6%
Shares in Total						
<i>Non-Oil Imports</i>	88.89%	86.62%	89.01%	90.58%	87.53%	88.5%
<i>Oil Imports</i>	11.11%	13.38%	10.99%	9.42%	12.47%	11.5%
<i>Memorandum Items</i>						
GDP (US\$ millions)	5,984.8	6,495.2	6,890.8	7,821.3	8,289.1	7,374.1
Real GDP Growth	4.5%	5.2%	3.1%	2.9%	4.9%	4.0%
Imports/GDP Ratio (%)	28.0%	29.8%	30.9%	30.0%	31.2%	30.5%
<i>Non-Oil Imports</i>	24.9%	25.8%	27.5%	27.2%	27.3%	27.0%
<i>Oil Imports</i>	3.1%	4.0%	3.4%	2.8%	3.9%	3.5%
Elasticities						
Imports f.o.b.	1.9	2.9	3.2	3.5	2.1	2.8
<i>Non-Oil Imports</i>	1.9	2.3	4.1	4.2	1.4	2.7
<i>Oil Imports</i>	2.3	6.9	-3.1	-1.9	9.4	4.1
<i>Source : Bank of Ghana - Annual Report, 1997 and CEPA Staff Estimates</i>						

6.5 External Debt and Debt Service

There is evidence of very widespread divergence in Ghana's external debt stock as measured by the Bank of Ghana (BoG) on the one hand, and the International Monetary Fund (IMF) on the other. Whereas both institutions seemingly use the same broad definition of public and publicly guaranteed debt (comprising long-term, short-term and the use of IMF credits), data on the country's external debt stock reported in publications of the IMF have been persistently higher than those reported in editions of the BoG's Annual and Quarterly Reports.

	1994	1995	1996	1997	1998	1999
IMF Data						
Total Public and Publicly Guaranteed	5,703	5,876	6,174	6,550	7,011	7,510
of which						
Multilateral (including IMF)	4,226	4,298	4,662	4,855	5,255	5,674
Bilateral	1,302	1,400	1,484	1,655	1,756	1,836
Other (Short-Term)	175	178	28	40	-	-
Bank of Ghana Data						
Total External Public Debt	5,022	5,074	5,347	5,651	5,922	6,001
Short-Term (Loans & Overdraft Facilities)	268	271	286	287	295	295
Medium-Term Loans (excl. IMF)	513	328	339	423	320	199
Non-Oil	502	317	328	412	309	188
Oil (Libya)	11	11	11	11	11	11
Long-Term	3,542	3,828	4,179	4,595	4,980	5,198
Bilateral	923	1,027	1,154	1,314	1,497	1,528
Multilateral	2,618	2,801	3,025	3,281	3,483	3,669
IMF Medium-Term Loans	700	648	543	347	327	309
of which						
SAF	172	135	104	59	61	60
ESAF	399	400	353	254	266	249
Others 1/.	130	113	85	33	-	-

Source: Bank of Ghana- Annual Report, 1997 and *Quarterly Economic Bulletin* (July-September, 1999); *Monthly Statistical Bulletin* (December, 1999); IMF- Staff Report for the 1998 Article IV Consultation and Midterm Review Under the Second Annual Arrangement under ESAF (November, 1998), Table 8, p.33

Note : 1/. Includes Standby facilities, Extended Fund facility, and Compensatory Fund facility.

The profile of Ghana's stock of external debt as presented in publications of the IMF and the BoG is shown in Table 6.5. It is interesting to note that the BoG's presentation is more detailed in the breakdown of the major components compared to the rather abridged profile of the IMF's (which, incidentally, permits no distinction between loans from other multilateral sources and use of IMF credit facilities). The presentations also show a widening trend of divergence between the aggregate stock of debt year after year, making attempts at reconciliation all the more difficult. It is noteworthy, for example, that the BoG estimate falls short of the IMF's by as much as US\$681 million in 1994, by an average of US\$842 million between 1995 and 1997, and by over US\$1.0 billion in both 1998 and 1999. Except for 1996, the yearly growth rates of the outstanding stock the external debt as estimated from the BoG data have generally been lower than those implied in the IMF data. .

While these data inconsistencies make it all the more difficult to assess the extent of the country's true external debt burden, they also raise serious problems for debt service payments and, therefore, for debt policy formulation and management. Reconciliation of the data among the various sources, therefore, will go a long way in minimizing these potential problems.

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