

**Review of the First Quarter Performance
of the Ghanaian Economy and Prospects
for the Rest of the Year.**

**By
Dr. J. L. S. Abbey**

*Paper presented at the Ghana Chamber of Commerce and Industry
on June 9, 2003*

1.0 Introduction and Background

In a review of macroeconomic performance under the expired Poverty Reduction and Growth Facility (PRGF) Arrangement over the four-year period 1999 – 2002, the IMF concluded that the sustained improvements in Ghana's economic performance that had been hoped for were undermined by recurrent policy weaknesses.

The medium-term strategy set out – under the PRGF Arrangement – in 1999 had envisaged:

- real GDP growth rising to 6% per annum;
- gross international reserves reaching 3 months import cover;
- domestic government debt maintained at or below 20% GDP; and
- divestiture of TOR, Ghana Airways, Ghana Railways and ECG.

In the event, erratic fiscal and monetary policies and persistent delays in structural reforms have left the economy in some respects weaker than it was four years ago.

The 4.5% real GDP growth and 15.2% CPI inflation of 2002 compare with 4.7% real GDP growth and 15.8% inflation recorded in 1998. The domestic debt stock rose by some 9 ½% GDP over the period (8 ½ percentage points in 2002 alone). The four major companies for divestiture/privatisation remain in state hands.

1.1 Macroeconomic stability

The GPRS acknowledges that attainment of its growth and poverty reduction objectives will depend in large part, on achieving and maintaining macroeconomic stability. The question then is how best to put the government budget on a sustainable footing, taking into account the spending priorities underlying the GPRS, and to protect it against some of the key vulnerabilities to which macro policies have been subject in recent years.

Among the macroeconomic vulnerabilities that could undermine the GPRS, recent experience has highlighted domestic energy pricing, and its implications for TOR and GCB, as a key risk factor.

The paper by the IMF “ The Challenge of Fiscal Sustainability in a Post-HIPC Era” presents data showing that the consolidated deficit of five of the largest public enterprises averaged almost 9½% GDP during 1999 – 2001, which exceeded the average deficit of the government over the same period. This underpins the importance of restoring the financial health of public enterprises for macroeconomic stability and private sector growth.

1.3 WAMZ (means of promoting wider regional economic integration) potential benefits from monetary union include – increased economic confidence, trade and cross-border investment – but there are challenging institutional requirements as well as the needed macroeconomic convergence, and above all, potential risks arising from dissimilar economic structure of the makers (for example, petroleum exporters (Nigeria) or petroleum importers (Ghana or la Cote d’Ivoire).

As of June 2002, Ghana had achieved only one of the four primary convergence criteria for entry. Most others were also some way off the targets. The timetable for the common currency has been moved from 2003 to July 1, 2005 to enable countries to apply fresh measures to meet the convergence criteria.

1.4 Economic Effects of La Cote d’Ivoire Crisis

The economic effects of the Ivorian crisis on Ghana are complex and difficult to quantify, but in net terms are not thought to be large, at least so far. Anecdotal evidence suggest that a considerable volume of regional transit trade has been diverted to Ghana, increasing business for ports and ancillary services, but at the same time imposing costs in terms of congestion and wear and tear on the roads system.

Increased policing of borders and care for refugees will imply some budgetary costs but these are likely to be modest and to be more than offset by the positive impact on cocoa prices and volume of shipments (reduced and possibly reversed smuggling – there is talk of a good crop year).

2.0 Macro-economic objectives (2003)

(i) Real GDP growth of 4.7% - deemed conservative but takes into account uncertainties in world economy as well as the ongoing crisis in la Cote d’Ivoire. Rising real interest rates and real appreciation could harm, but projected positive TOT developments would stimulate, economic growth.

(ii) Forex reserves build-up to 2.3 months from just over 2 months last year.

(iii) Inflation target of 22% from original 9% - clearly ambitious on monetary developments of second half of 2002 and the subsequent petroleum and utility price hikes. GOG was reportedly “determined, however, to adhere to stated goal of achieving single-digit inflation in 2003, and believed it was attainable.”

Elimination of domestic borrowing by government is expected to lead to some reduction in real interest rates while making room for an expansion of bank credit to the private sector.

Given the seasonality of revenues, however, government will need to borrow domestically in the first half of the year, but on a scale significantly lower than in 2002, and the borrowing will be repaid as revenues pick up in the second half.

The exchange rate would continue to be market-determined with interventions by BOG limited to smoothing short-term fluctuations and achieving the targeted \$130 million in net international revenues (NIR).

Ghana has accepted Article VIII obligations and has an exchange rate system free of restrictions on the making of payments and transfers for current international transactions (current – account convertibility).

The competitiveness of the economy is not considered to have been impaired by the modest appreciation of the RER in 2002, which was outstripped by the positive changes in Ghana’s TOT (+9.1%).

Making room for added social and poverty-related spending and/or the delivery of services previously unavailable to the poor ameliorates the otherwise negative impact of revenue mobilisation or expenditure rationalisation measures.

3.0 Selected Issues

3.1 Money

With a view to increasing the effectiveness of its monetary instruments, the BOG established a “prime” interest rate in March 2002. The prime rate is the rate charged to commercial banks for borrowing from the BOG with T-bills as collateral.

The BOG has raised its prime rate in two steps since the beginning of this year by a combined 3 percentage points (to 27.5 %) and has stepped up its open market operations (OMO) to withdraw liquidity from the system. This was first in response to the monetary developments of the second half of 2002 and subsequently the January 17, 2003 petroleum price adjustments. These latter triggered a sudden upward shift in inflation expectations, prompting a reversal of the build-up in real money balances that had taken place in the latter part of 2002.

There is the belief that the shift in expectations was enhanced by some opportunistic, or speculative, price increases in the retail sector.

3.2 External

Larger-than-normal inflows of foreign exchange from the pre-financing of the cocoa crop contributed to the rebuilding of international reserves and an associated acceleration in money growth in the fourth quarter of 2002. Gross international reserves recovered to nearly two months of imports despite a substantial shortfall in external program support – loans and grants.

Ghana’s medium term plan for the reform of its tariff regime are bound up with those of ECOWAS, the members of which “have yet to agree on a time table for the next phase of tariff reforms”. The only major change in the trade regime over the last two years has been the abolition in July 2002 of the special import tax.

Elimination of this tax was announced in Budget (2002) in March but was not approved by Parliament until July. And yet its elimination in March 2002 was a structural performance criterion (or conditionality) under the PRGF Arrangement with the IMF.

Against this background, Budget (2003) proposed several increases in external tariffs to provide increased protection to certain domestic industries. The main proposals were:

- an increase in duty on a range of imported finished goods from 10 to 15%; (see paragraph 599 of Budget 2003);
- an increase in the import duty rate on rice imports for 20 to 25% “to increase domestic production of rice in order to reduce reliance on imports and thereby conserve foreign exchange “ (see paragraph 600 of the Budget 2003; and
- a supplementary duty of 20% on poultry products . The rationale was that the domestic industry is “facing intensive competitiveness in the affected sectors.

A Domestic Content bill which would set targets for; if not actually require, companies operating in Ghana to source a prescribed minimum of their inputs domestically, rather than from abroad was discouraged by the IMF. The reason given was that requiring minimum domestic content could contravene Ghana’s world Trade Organisation (WTO) obligations.

Furthermore, Fund staff contended that “such a measure could impair the efficiency of local producers and deter potential investors. A suggested “better approach would be to identify and address underlying factors that discouraged more voluntary use of domestic content”.

Simplification and greater transparency of Ghana’s trade regime “so as to reduce the compliance burden on foreign business wishing to trade with, or invest in Ghana, under consideration by the ministry of trade are seen as more positive.

Measures to enhance long-term competitiveness and to facilitate the expansion of Ghana’s international trade rather than protectionist measures are seen as the way forward. Clearly, the issues are joined considering a recent CDD Survey which found that Ghanaians are willing to pay higher price for increased domestic jobs.

Interestingly, on textiles paragraph 604 of budget (2003) states:

To make local production of textiles more competitive compared to imported products, it is recommended that duty on the inputs for textile production such as grey baft be reduced from 10 to 5%.

It is important to note that “the standard injunction against imposing or intensifying restrictions on current payments or imposing or intensifying import restrictions for balance of payment reasons “is a continuous performance criterion” under the new PRGF Arrangement agreed with the IMF.

3.3 Fiscal

A major objective during 2003 will be to bring the wage bill under control. A hard budget constraint – a move that will be explicitly endorsed by cabinet in March 2003 – will aim to limit the overall wage bill to no more than ₺5,450 billion, implying a 22% increase on the underlying base for 2002. The staff argued that the implied farther real raise in the wage bill (from 8.5% to 9% GDP over 2002 – 2003) was high, given the substantial pay increases granted in earlier years and the need to meet the key objective of curbing inflation. The authorities felt, however, that a smaller wage increase was not politically feasible at a time when petroleum and utility prices were rising sharply and new taxes were being imposed.

The broad objective of the 2002 Budget and Economic policy of the government were undermined by serious fiscal and quasi-fiscal slippages and associated weaknesses in PEM.

Particular problem areas included:

- an overrun in the wage bill, owing to unbudgeted pay and grade increases primarily in the health and education sectors (partly to stem brain drain and disruption of services; although political reasons have also been cited).
- payments in early 2002 relating to previously unreported and unbudgeted expenditures in late 2001 (an issue of good governance and parliamentary oversight) which distorted the expenditure allocations approved by Parliament.
- non-implementation of the VAT rate increase scheduled for mid-2002.

- failure to adjust petroleum prices according to the agreed mechanism in the face of world market price and exchange rate developments; as well as a three month delay in raising electricity and water tariffs and which consequently added to the subsidy bill for utilities.

To stay within the appropriations bill, capital spending was compressed, and arrears to statutory funds built up, further distorting budgetary execution. It must be emphasised that although there was a faster-than-planned clearance of the stock of arrears outstanding as of end-2001 the evidence points to further increases in the net stock including statutory because new arrears increased faster still. In the case of road arrears – expected to have been fully cleared by end June, the stock was estimated at ₪220 billion by end December 2002 (down by a meagre ₪68 billion from the end 2001 stock of ₪288 billion).

The two key parameters to medium-term fiscal sustainability are seen to be:

- the domestic revenue mobilisation effort; and
- the government wage bill.

The wage bill has expanded rapidly in recent years and government has agreed with the Bretton Woods Institute that “fundamental civil service reform was essential to contain, and preferably, reduce the wage bill as ratio to GDP. It is expected that a detailed civil service reform plan will be worked out this year, with support from the World Bank and other donors. The hope is that savings expected to be realised would permit a better allocation of scarce budgetary resources, while creating scope to improve the quality and effectiveness of the service.

In order to complement monetary policy and begin reducing the burden of domestic debt, fiscal policy will maintain (even after the adjustments in prices, expenditures and nominal national income) the zero net domestic financing (NDF) target for 2003.

In reconciling this objective with the GPRS objective of increased spending on poverty-related and other priority spending two principal tax measures have been introduced with Budget (2003):

- a new national health premium (NHP) – in effect a 2 ½% points increase of VAT rate (half of the first-year proceeds devoted to funding the start-up costs of a new eventually self-financing national health insurance scheme). Under the National Health Insurance System (NHIS) every citizen (except the aged) would make contributions, while GOG provides seed money for the system to be launched

in all 110 Districts. The NHIS replaces the “cash-and-carry” system of user fees for the provision of health services in Ghana, giving the beneficiaries the risk protection inherent in any insurance scheme. The start-up of the NHIS is assumed to absorb 25% of NHP proceeds next year, and zero thereafter.

- a Debt Recovery Levy (DRL) equal to c640 per standard unit (litre or 1000 kg) on petroleum products which now estimated to generate 1.4%GDP (initially 1.6% GDP and 1.9% in a full year). The DRL’s primary motivation is to defray the costs to the Budget of servicing the so-called TOR bonds – the bonds issued to the banks in replacement of TOR’s debts arising from past failure to adjust petroleum product prices as warranted by rising cedi import costs. It is equivalent to approximately 14% of the pre-budget retail price of premium petrol. It replaced the earlier proposed petroleum debt service surcharge (PDSS).
- other revenue measures with combined yield in 2003 of 0.7% GDP are the National Reconstruction Levy (extension for one additional year) expected to yield 0.2% GDP and stumpage fees and the opening up of timber concessions to public auction with expected combined yield of 0.5% GDP.

As far as the impact of these revenue measures on the poor, it is argued that the NHP is relatively progressive in the sense that the highest quintile of income earners would bear almost two thirds of the burden compared to only 3% for the lowest quintile.

In respect of the DRL, the cross product price subsidisation was assumed to be sufficient and not needing to be augmented. Our analysis suggests otherwise with large surpluses in the “cross subsidy” fund.

Furthermore, it is contended that to the extent that these revenue measures make room for added social and poverty-related spending and/or the delivery of services that previously were unavailable (or the restoration of a previous service), their impact on the poor would be further ameliorated. The principles being enunciated here are critical to the GPRS under the Enhanced HIPC process.

A substantial increase has been programmed in capital and priority poverty-related expenditures. Total capital expenditures (measured in shares of GDP) are set to increase by nearly 60% over those of 2002. The 2002 figure, it must be emphasised, was unusually low owing to both smaller-than-expected donor project disbursements and payment cutbacks in domestically funded capital spending. Experience and analysis both suggest that these financing problems led to accumulation in payment arrears.

Poverty-related expenditures (GPRS definition) are also scheduled to increase (in shares of GDP terms) by a third over 2001 (the last year before the HIPC Initiative Decision Point).

The cost overruns noted earlier and the continued accumulations of payment arrears whenever attempts have been made to contain spending underscore the need to reinforce the public expenditure management (PEM) system. Various initiatives are under consideration including:

- the re-launch of a new improved budget and public expenditure management system (BPEMS) (with World Bank support);
- increased MDA accountability for verification of wage rosters; and
- the introduction of quarterly (as against monthly) new cash management system basis on rolling (updated and privatised) spending projections by each MDA with the objective of improving control of spending at the commitment stage.

After recent adjustments and subsequent parliamentary approvals to ensure full cost recovery (together with taxes, levies and margins as required), the National Petroleum Tender Board and the Public Utilities Regulatory Commission (PURC) – both with independent powers and publicly stated mandates – are charged to bring the finances of TOR and the public Utilities into order by putting an end to their quasi-fiscal activities.

Negotiations in respect of contractual obligations over the supply and price of power between VRA and VALCO need to be quickly completed in order to put the finances of the VRA into shape. Currently, VRA is said to be incurring significant losses on account of implicit subsidies to VALCO.

3.4 Private sector

Difficulties encountered – particularly by SME's and the rural population – in accessing bank credit and other sources of financing on appropriate terms is “a constant refrain” in public discussions.

- Legislation to allow the creation of private pension schemes, as an instrument for mobilising LT funds for the business sector;

- Establishment of a legal framework for credit reference agencies, to address one of the key obstacles to accessing credit namely: the difficulty for potential borrowers to establish a “certified” credit history;
- Increased funding and technical support for rural and microfinance institutions;
- Strengthening the finances of major public enterprises especially TOR and the public utilities and more generally the public enterprise sector; and
- Above all, an effective public expenditure management system that is full integrated in the budgetary preparation and approval process.

3.5 Statistics

The Fund now reports that according to its peripatetic adviser to the GSS, “as a result of a methodological change in the compilation of the consumer price index (CPI) in 1999, the level of the CPI, and the national accounts at current prices derived from it may have been substantially under-recorded for the period since 1999.” His preliminary calculations suggest that at end-2000, the inflation rate may have been closer to 65% than the reported rate of 40%.

A practice of facing a “no price change” into the system when a missing observation first occurs – certainly inappropriate in periods of high inflation – is blame for this serious statistical blunder. To compound matters a procedural error was added. The assumed zero price change was perpetuated even when data became available subsequently.

Upward revision of the CPI would lead to a rise in the calculated GDP at current market prices, since “the GDP series is derived by multiplying volumes by respective prices some of which are substituted by the CPI when specific prices are unavailable. Accordingly, the advisor is reportedly “working to recompute the CPI indices using a revised treatment for missing data, and to re-estimate nominal GDP, with a view to publishing both revisions by mid-2003”. This is clearly unacceptable. The national income statistics cannot be left to a peripatetic advisor, or outside experts.

One particular implication of the data revisions of extreme national importance concerns the wage bill. The projected 9% of GDP for 2003 on the existing data would fall to a lower ratio with the revised GDP “though it would likely remain above the 5-6% GDP that is typical in low-income developing countries.

3.6 Inflation

The jump in prices – 2.0% in January, 12.8% in February and 2.5% in March – is a “one-time” realignment, as traders throughout the economy marked up their prices in response to the “larger-than-anticipated” hike in petroleum prices. The impact of the latter was disproportionately greater than that of February 01 because “people had become accustomed in the intervening period to relatively low and stable rates of (COI) inflation”.

It may also be noted that a part of the March inflation figure included the impact of the 12% increase in the electricity and water tariffs. The size and timing of these tariff increases had been publicised months in advance, however, and may very well have been factored into the program’s inflation projections. On the strength of this may not have contributed significantly to the “higher-than-expected” inflation in March.

The revision from 9% to 22% “corresponds broadly to the overrun in inflation observed during the first quarter, and assumes that prices evolve approximately in line with the original program for the rest of the year.

Unfortunately even the revised target is still ambitious. It would require exemplary fiscal performance and sustained macroeconomic stability, a steady decline in petroleum prices in international markets and a good harvest.

Unfortunately even the revised target of 22% by end of the year is still ambitious. It would require among other things:

- an exemplary fiscal performance complemented by aid flows as programmed and a generally sustained macroeconomic stability, with much lower interest rates;
- a decline in petroleum prices on international markets for the first quarter average of \$31 per barrel to no more than \$25 per barrel average for the fourth quarter; and
- an exceptionally good food harvest.

4.0 Prospects

A press release dated May 23, 2003 issued by the Monetary Policy committee of the Bank of Ghana, provided its review of macroeconomic performance for the first quarter of 2003 and the outlook on inflation. The review noted that macroeconomic developments in the quarter have been underpinned by several factors:

- total revenue exceeded the budget target by some c90.0 billion;
- total expenditure was contained below the budget target;
- the domestic primary balance – (domestic tax and non-tax revenue less non-debt recurrent) and domestically financed capital expenditures – showed a surplus compared to a projected deficit;
- the domestic stock rose by 3.9% - less than half of the first quarter of 2002 and quite significantly all of that held outside the banking system ;
- government actually improved its financial position with the banking system contributing to a slowdown in the growth of monetary aggregates led by a 17% decline in reserve money which enabled the Bank of Ghana to leave its Prime Rate unchanged at 27.5% after the increases in January and February.

Assessment of performance is plagued by data problems. Like the IMF, the BOG assess performance on the basis of data from the banking system. Given the serious financing problems faced by the government and the tendency to delay payments, reliance exclusively on banking sector data could paint a rosier picture than warranted. There has been a lot of improvement from the days when the BOG actually bounced government cheques. But reports of payment arrears abound. In the circumstances, healthy bank balances could be illusory with large amounts of payment vouchers bloating up the float.

The record also shows that the official estimates of budgetary outcomes in the annual Budget statements which are based on payments data the CAGD themselves fail to paint the reality inasmuch as payment arrears continue to mount including of statutory transfers. In recent times – starting from late 1999 to 2002, large unfunded subsidies have also led to rising debt at TOR and the public Utilities which must be taken into account in a proper assessment of macroeconomic performance.

The assessment of the IMF of performance over the four-year period of the failed PRGF Arrangement needs some important qualifications. Key among these is the governance issue. Close on its heels national

ownership. The facts are that, as discernable from the public debates on issues ranging from trade and protectionism to procurement, divestiture, private sector participation in the provision of such public goods as water, power and petroleum products, monetary policy, parliamentary oversight, the role of the media, law and order, the security agencies, independence of the judiciary, etc.

Ownership of the development agenda is increasingly becoming national rather than narrowly confined to the government of the day. These are the reasons why the prospects for the rest of this year and into the election year 2004 depend on what we do collectively through our national institutions for economic and political good governance. Above all we must strive to ensure that partisan politics is kept in its place. That way we can take responsibility for the success or failure of our collective endeavour.