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INTRODUCTION AND SUMMARY

Ghana's medium term development agenda is spelt out in the Ghana Poverty Reduction Strategy (GPRS), which represents comprehensive policies, strategies, programmes, and projects to support growth and poverty reduction. The Budget Statement and Economic Policy of the Government of Ghana presented to Parliament each year are in effect, annual installments assessing performance to date and the way forward.

The CEPA appraisal of the budget statement is in five parts. The first three deal with the macroeconomic policies and their implementation. These are grouped into Public Finance and Fiscal Operations; Monetary and Financial Sector Developments; and External Sector Developments. The next two parts deal with Reaching Completion Point in the HIPC Process and monitoring and evaluating Real Sector Performance as measured by the real GDP and its component sectors.

Public Finance and Fiscal Operations

The key issues that led to the veering off-course of the Ghanaian economy which culminated in the demise of the Poverty Reduction and Growth Facility (PRGF) Arrangement with the IMF on November 30, 2002 included the following:

- persistent significant weaknesses in budget implementation and in parastatal finances; and
- inadequate sterilization of the inflows of foreign exchange (for the financing of the cocoa crop).

Using the traditional summary assessments of the domestic primary balance (DPB), overall primary balance (OBB) and net domestic financing (NDF) the official provisional actuals show an impressive outcome.

However, available information, including from the IMF website suggests that the transfers actually made to the public utilities and TOR for subsidies fell considerably short of what was due. CEPA estimates adjust for such technical payment arrears. The adjusted estimates show that while progress was undoubtedly made, weaknesses in budget implementation and parastatal finances still persists.

Looking ahead into the medium term, CEPA estimates a financing gap to be realized for 2004 of about 2.2% GDP if the net domestic financing of the budget target is to be realized. The sources of this financing gap include the following:

- the transfer of ₵420 billion into the National Health Insurance Fund (NHIF) is not fully funded;
- an additional unbudgeted-for transfer will have to be made to fund price subsidies for the utilities and petroleum products on account of delays in policy implementation; and
- the payment arrears to the public utilities and TOR carried over from 2003 is expected to be cleared this year in addition to road sector arrears.

The implementation of Budget (2004), which is necessary for reaching Completion Point in the HIPC process this election year, would also depend on the success of making two key structural changes:

- the phased deregulation of the petroleum sector; and
- the institutionalization of the National Health Insurance Scheme (NHIS).

Monetary and Financial Sector Developments

Strong complementarity of fiscal and monetary policies was achieved as the target of zero net domestic financing of the budget was overachieved with a net repayment equivalent to 0.4 percent of GDP in 2003. This gave rise to monetary developments with far-reaching positive repercussions for the financial sector.

The better-than-programmed fiscal outturn meant much reduced borrowing by Government on the open market. Thus while in 2002 net credit to Government increased by about 55 percent, in 2003, Government rather paid back some of its domestic debt; specifically, net debt held in the banking system was reduced by 1.7 percent of GDP, causing net credit to Government to decrease by about 15 percent. This led to a desirable ‘crowding-in’ effect on the private sector with credit to the private sector increasing almost five-fold.

Another positive monetary consequence of the fiscal outturn was reflected on developments in interest rates. For several years the term structure of interest rates in Ghana has rates on short-term instruments being more attractive than those on long-term instruments. In other words financial investors did not place much premium on long-term holdings; and that was not good for development. With the fiscal making less demand on deficit financing short-term interest rates began to fall.

Along with the falling rates of inflation and the weak demand by government for short-term domestic financing, the Bank of Ghana has been signaling to the financial market better times ahead by reducing its prime rate. The banks in turn, have been responding by reducing their base rates. Whereas the real base rates are coming within reasonable limits, the spread between saving and loan rates still remains wide at an average of about 20 percent. With Treasury bill rates falling, banks would have to do aggressive but prudent lending to stay afloat. This will help the business sector obtain the essential credit for increased production, which will enable the country to achieve higher growth.

External Sector Developments

In the external sector, Ghana recorded a current account surplus in 2003 in spite of a deterioration in the terms of trade. This, together with larger-than-expected external program support – loans and grants – enabled the country to increase her gross international reserves substantially from the equivalent of two

months to approximately four months of import cover. In contrast to 2002, the increased gross international reserves was achieved in a stable exchange rate regime.

The cedi thus depreciated in nominal terms by about 6.0 percent against the US dollar in the Interbank market and by about 5.0 percent in the Forex Bureaux market. Part of the low level of depreciation against the US dollar was due to the dollar's own weakness in international markets in 2003. The US dollar depreciated against the Euro, the Pound Sterling and other major international currencies.

With a high but declining rate of inflation, the low level of nominal depreciation led to a real appreciation of the cedi against the US dollar, although real appreciation nevertheless left the cedi still undervalued. According to Bank of Ghana data, however, it was on account of the larger depreciation of the cedi against the euro and other international currencies, that the real effective (trade-weighted) exchange rate depreciated by 9.8 percent in 2003. This means broadly that while Ghana lost competitiveness in the US market, it more than made up by increased competitiveness in Europe.

The Budget for 2004, while expecting that the exchange rate will be determined by supply and demand for foreign exchange, expects the Bank of Ghana to intervene to smoothen temporary fluctuations in the rate. Such Bank of Ghana intervention in the market, however, must be subject to the maintenance of the competitiveness of Ghana's exports and achievement of the international reserves target. The exchange rate must be seen essentially as an instrument of external sector adjustment. It may be preferable to maintain an undervalued currency to encourage exports rather than an overvalued exchange rate for inflation control, which is not sustainable. That said, it must be added that in the present situation, there is a rare window of opportunity to use the exchange rate responsibly as one in a package of anti-inflation instruments.

Reaching Completion Point

The objective of the enhanced HIPC Initiative is to reduce the debt of eligible countries to sustainable levels. This is to be achieved by the country implementing a macroeconomic program endorsed by the World Bank and the International Monetary Fund (IMF) and receiving debt relief over and above what would be obtained through the traditional debt relief mechanisms. In addition, the recipient country is expected to utilize the savings from debt relief in activities that are growth enhancing and poverty reducing.

In the case of Ghana, there are 15 Completion Point triggers covering areas such as the macroeconomy, governance, public expenditure and management, social indicators, decentralization and energy.

Some progress has been made in satisfying the completion point triggers. The Poverty Reduction Strategy Paper has been prepared and been implemented for one year. However whether or not implementation has

been satisfactory depends on the assessment by the staffs of the IMF and World Bank of the country's annual progress report.

The expectation of the Government of Ghana (GoG) is that Ghana would reach Completion Point by the middle of this year. As the Minister for Finance and Economic Planning confidently stated in Budget 2004 (738):

Ghana expects to reach HIPC Completion Point (CP) this year, when we would have attained the triggers for floating CP.

The Executive Board of the IMF appears more guarded. From its perspective, satisfactory performance means containing losses in the energy and utilities sector. Implementation of an automatic price adjustment mechanism for the petroleum sector is a trigger. There appears to be a modification in strategy - there is a shift towards the full deregulation of petroleum pricing. A concern, however, is the impact this will have on social objectives.

It is in the health sector that progress to attain the triggers may be described as disappointing. If speedy and efficient action is not taken to address the situation, failure to attain this target could undermine the guarded optimism of the Deputy Managing Director of the IMF and the Minister of Finance and Economic Planning. To meet one of the health trigger point requirements, the percentage of households with access to safe water should be at least 46%. In 2003 the estimated ratio stood at 44%. The 2004 Budget states that there has been an upsurge in the incidence of guinea worm disease. This is disappointing, especially since in the 2003 Budget statement the Minister of Finance and Economic Planning identified seven specific areas of service delivery in health that were to remain the priority for 2003. One of this was guinea worm.

Once Ghana has attained Completion Point by meeting all its triggers, the debt relief commitments will be made available to it.

Real Sector Performance

The account given in Budget 2004 of real sector performance as measured by real Gross Domestic Product (GDP) and its sectoral components caused a bit of a stir in political circles. Real GDP rose by 5.2 percent in 2003 – the best in recent times and better than projected for the year. At the same time, the Services sector – the second largest with a share of about a third of GDP – performed less well than expected.

Indeed, if all other things had remained as projected, the overall GDP growth would have reduced to 4.6 percent – only marginally better than registered in 2002. But Agriculture, the largest sector, registered accelerated growth beyond projected. This not only made up for the Services sector, but also enabled the overall growth rate to be moved up from the projected 4.7 percent to 5.2 percent.

The super-performance of Agriculture in 2003 was exclusively on account of cocoa production and marketing, with output rising from a slight decline in 2002 to a sturdy performance of 16.4 percent growth – a turnaround of nearly 17 percent. Established output patterns, however, make the projected growth of 13.1% for 2004 rather unrealistic.

A number of unresolved statistical deficiencies – computational errors in the CPI and problems in the compilation of the national accounts – have been identified and documented by researchers at CEPA as well as at the IMF. Attempts are being made at the Ghana Statistical Service (GSS) to tackle these but greater support to the Service is necessary to expedite action.

There are widespread and legitimate concerns about what appears to be an ambitious growth strategy which is, moreover, dependent on the exploitation of non-renewal natural resources – land, forests and minerals. Compelling evidence suggests that these natural resources are being exploited in an unsustainable manner – jeopardizing future growth and human development potential.

Current policies on agriculture, forestry and fisheries assume ever-increasing growth potential from renewable natural resources despite evidence that the natural resource base is reducing in both quality and quantity.

In this regard, the modernization of agriculture policy of Government with the active collaborative support of the World Bank points clearly in the right direction.