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Efficiently Expand and leverage Fiscal Space to Promote Inclusive Growth and MDG Acceleration in Ghana

United Nations Development Programme

Inclusive Growth Cluster, Ghana

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Executive Summary

1. This study examines how Ghana can efficiently expand and leverage fiscal space (broadly the room within the budget) to sustainably promote rapid, inclusive growth and accelerate progress towards the Millennium Development Goals (MDGs).
2. Ghana has many advantages to help foster these goals: a well-established natural resources export sector, an emerging petroleum economy, a stable political system, enterprising hard-working citizens, engaged private sector investors and supportive development partners. Yet, successive governments have missed opportunities to efficiently expand and leverage the country's fiscal space for these purposes.
3. Ghana's economy is on an unsustainable trajectory. The country has large, persistent budget and balance of payments deficits, rising inequality, growing disparities across sectors and regions, rising inflation, low public sector productivity, and a public sector debt burden that is beyond any prudent debt capacity limit.
4. These difficulties have shown up in the progress being made towards achieving the MDG targets and in other dimensions of social protection and human development. Some MDGs (poverty reduction, primary school completion, and access to potable water) have been met ahead of time. Others, such as under-5 mortality, maternal mortality, gender equality, and access to improved sanitation, are off-track by wide margins. The average performances (and achievements) seriously mask major disparities in performance when measured across regions, age groups, and by gender.
5. The recently introduced 2014 Budget provided a much needed opportunity for the Government of Ghana (GoG) to respond constructively to these challenges. The GoG's approach, summarized in paragraph 12 of that Speech, included the adjustment of subsidies, moderation of the public sector wage bill, various tax changes, limits on new contracts and new loans, improvements in budgeting, among other measures. When viewed against the background of recent fiscal trends, however, these measures (and the overall Budget itself) represent a missed opportunity to make a major shift in the economy's direction. Specifically, the measures do not free up fiscal space through which social objectives such as accelerating MDG achievement can be pursued. Wage payments and debt service absorb the bulk of government revenue, implying that the most of the resources to finance public investment and operations and maintenance have to be borrowed. These features contributed to the recent debt downgrades by international rating agencies and other adverse reactions e.g., in the parallel foreign exchange market.
6. An effective response to the economy's difficulties will require both short and long term measures. This paper suggests changes through which the government can begin to improve its economic management. In the short-term, the measures suggested by the GoG need to be intensified and the GoG needs to restrict its borrowing. There is no sustainable path forward based on more deficit spending and additional borrowing. Over the longer term, economic policies (some of which the GoG has already noted) need to rebalance the economy by bringing production into line with absorption, savings with investment, the supply of money with the demand for money, imports with exports, and borrowing with debt servicing capacity. These policies and actions involve the reorganization of and cuts in government expenditure, major improvements in revenue collection, the more efficient use of development cooperation, a reduction in public sector borrowing, and a competitive international exchange rate. They should reduce inflation, stimulate private savings and investment, raise productivity, and redress inequality.
7. With improvements in both the budget and the overall management of the economy, Ghana will begin generating the fiscal space needed to support rapid inclusive growth and to ensure that progress continues towards the attainment of MDGS. Without these changes, Ghana faces a future of economic instability and vulnerability to external shocks, limited human development, and minimal progress towards the MDGs.

1. Introduction

The study seeks to understand the means by which the Government of Ghana (GoG) can create and better manage fiscal space as part of a broader strategy to promote and sustain rapid inclusive growth and accelerate progress towards the Millennium Development Goals (MDGs). Box 1 defines the key concepts.

Many of the problems that need addressing have intensified since the analysis of fiscal space carried out by the same authors in 2010.[2] Those findings are summarized in Box 2. Both internal and external factors played a role. Externally, the commodity "super-cycle" has ended, local and international confidence in the economy is declining, and there is a progressive reduction in development assistance now that Ghana is classified as a lower middle-income country (LIMC). Internally, rising inflation, growing inequality, delays in realizing the expected returns from the Jubilee oil field, continued low savings and investment, and persistently large budget and balance of payments deficits which have pushed Ghana's debt to unsustainable levels, raise questions about the future sustainability of growth and development.

Box 1: Key Concepts

Fiscal space

We define fiscal space as "the capacity of the national budget to provide the resources required to meet desired public goals [such as sustainable human development] without jeopardizing the Government's financial position or the stability of the economy." We also understand that "creating and sustaining fiscal space are part of the process whereby a government mobilizes and allocates its financial resources comprising domestic revenues (including asset sales), local and foreign debt, socially productive expenditures, and foreign assistance". (See references in Annex 1)

Inclusive growth

Inclusive growth – also referred to as shared growth, pro-poor growth, and broad-based growth – focuses attention on a particular country's pace and structure of growth. Definitions include: "…growth that not only generates economic opportunities, but also ensures equal access to them by all members of a society…." ; sustained (economic) growth, the broad sharing of opportunities and benefits of growth, and growth that involves the coherent interaction among all sectors of the economy; the combination of rising income and equal opportunities; "raising the pace of growth and enlarging the size of the economy, while leveling the playing field for investment and increasing productive employment opportunities"; and "higher levels of employment, alongside social and territorial cohesion." In a recent IMF analysis, inclusive growth was defined as "growth that raises the income of most or all in society, including the poorest groups." These definitions tend to mix description and strategy (e.g., the focus on productive employment). They also tend to be growth-leads-distribution (or trickle down and out) variety. The definition proposed by the African Development Bank, which we follow, gets directly to the point: "Inclusive growth involves circumstances where all members of society contribute to, participate in, and benefit from sustained economic expansion."

Numerous policy documents emphasize the GoG's determination to promote inclusive growth. It has been a central theme of its national development framework *"Ghana shared growth and development agenda"* (GSGDA) 2010-2013[3]

[2] UNDP/GoG,2011

[3] NDPC, 2010

It is part of the GoG's *"transformation agenda"* of economic diversification, social inclusion and job creation, and macroeconomic stability.[4] Inclusiveness featured prominently in the recent Budget Speech.[5] Successive Ghanaian governments have promoted inclusiveness in several ways, most notably through programs to boost social protection such as the National Health Insurance Scheme and Livelihood Empowerment Against Poverty (LEAP), reduce poverty, and promote the achievement of the MDGs.[6]

Notwithstanding these efforts, recent rapid growth in Ghana has been associated with rising inequality, widening disparities across sectors and regions, and an increased degree of informality throughout the economy. That is, the whole population has *not* participated in, contributed to, and benefitted from the economic expansion.[7] This is unfortunate since inclusive growth (as defined above) is inseparable from inclusive human development, i.e., the process by which all citizens share the opportunity to broaden their capabilities and enlarge their choices.[8]

Generating fiscal space through which the public sector can support activities that expand these choices is a dynamic process. It reflects the interactions between the flows of revenue and expenditure (which determine the budget deficit/surplus) and changes in the stocks of local and foreign debt and flows of foreign assistance. Each of these elements, in turn, is influenced by the macroeconomic context, particularly the quality of macroeconomic management.

In practice, Ghana should be able to generate and sustain the fiscal space needed to support the public sector's operations including the promotion of the MDGs and other social objectives. The country has substantial advantages – a well-established export sector, an emerging petroleum sector, significant tracts of well-watered fertile land, large inflows of foreign investment and remittances, enterprising and hard-working citizens, improving education and health, deepening democratization, political stability, and supportive development partners.

Despite these advantages, successive governments have not effectively created and leveraged the necessary fiscal space. Poor macroeconomic governance (Box 3) has played a major role. The large, persistent, budget deficits have accelerated the accumulation of local and foreign debts.[9] The extreme rigidity within the expenditure side of the budget (the result of earmarking and the dominance of wage payments and debt service) makes it difficult to improve efficiency. Tax effort, though improving, is approaching its practical limit. Furthermore, now that Ghana is a LMIC, aid and concessional finance will continue to decline. This leaves little room to maneuver.

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[4] IMF, June 2013, pars. 8,9, pp. 7-8

[5] The Budget Speech uses "inclusiveness" in two contexts. The Hon. Minister referred to accelerated infrastructure investment and institutional development as the laying the "foundation for the next decade of inclusive and shared growth." He also quoted HE the President whose vision of Ghana comprises a "stable, united, inclusive and prosperous country with opportunities for all" (Budget Speech, November 2013, pars. 7, 13).

[6] For example, see Section 6 of November 2013 Budget Statement, pp. 155-167

[7] This point is evident in a recent IMF discussion of inclusive growth (IMF 2013, Appendix II).

[8] UNDP, 2010

[9] The rapidity with which Ghana's debt has been accumulated suggests that the decades-long period of debt-depression prior to HIPI/MDRI relief offered any tangible lessons in prudent national debt management.

Box 1: Leveraging Fiscal Space for Human Development in Ghana: The 2015 MDG Targets and Beyond[10]

The study examined how Ghana could expand its fiscal space to support human development in ways that accelerated progress towards achieving the MDGs. For several MDGs, Ghana had made noteworthy progress. Yet, the deteriorating fiscal and debt situations from 2008 onwards (even with the prospect of oil revenues) raised doubts whether the progress could be sustained. After reviewing the constraints, opportunities and broader macroeconomic context, the study concluded that Ghana had minimal scope for rapidly expanding fiscal space. Its history of large, persistent budget deficits and low savings precluded a deficit-driven investment strategy. Its recent elevation to Lower Middle-Income Country (LMIC) status ruled out the prospect of increased aid flows. An expanded tax effort was needed just to cover rising wage and interest payments. The anticipated oil revenues did not change these conclusions especially since the budget deficits from 2008 onwards were effectively 'pre-spending' a large share of the oil receipts (projected to be $1 billion per year). Moreover, having access to oil revenue did not directly address the economy's structural imbalances (low savings, weak productivity, an over-extended public sector, chronic inflation, and an overvalued exchange rate). Furthermore, the potential impact of oil revenue had been diminished by the rebasing of GDP. That exercise—which revised Ghana's GDP upward by 75%[11]—modified several key indicators (such as the debt ratio and the budget deficit as a share of GDP) but it had no impact on critical structural features (productivity, thrift, regional balance, human capacity) that are the foundation of rapid inclusive economic growth and MDG acceleration.

The study concluded that the principal means for Ghana to create additional fiscal space to boost progress towards the MDGs by 2015 would be through adjustments within the budget. Expenditure would need to be reallocated, the effectiveness of revenue collection improved, the efficiency of public sector operations raised, and the least socially productive activities cut (especially the wage bill and subsidies).

The study noted that the Government could also add to fiscal space by improving macroeconomic management in ways that raised the sustainable rate of economic growth. Specific actions suggested included a sharp reduction in the budget deficit, keeping the national debt (local and external) on a sustainable trajectory, achieving and maintaining a competitive exchange rate, cutting the losses and improving the efficiency of State-Owned Enterprises, and reducing the regulatory burden.

These measures would help re-balance the economy, stimulate private sector activity, and raise overall productivity, particularly of labor. The study recognized that none of these adjustments would be easy. Moreover, few of them were what the GoG or the general public expected. With the discovery of oil, the majority of Ghanaians anticipated sharing in a brighter, more prosperous future. Oil revenues could play a part in that, although they would not be adequate to drive future prosperity. For that to happen, there would need to be higher levels of human development derived from the prudent management of *all* of the country's resources, including those devoted to accelerating progress towards the MDGs.

The 2014 Budget Speech was framed with these difficulties in mind. Its theme "Rising to the Challenge: Realigning the Budget to meet Key National Priorities" was, at one level, a recognition that the 2012 budget and deficit reduction measures in 2013 were not up to the task and accordingly likely intensified the country's difficulties.[12]

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[10] UNDP/GoG, 2011

[11] GSS 2010, p.7

[12] The "realigning priorities" dimension of the GoG theme mirrors the IMF Country Report's discussion of fiscal policy (see IMF June 2013, pp.8-16).

The government's approach, summarized in paragraph 12 of that Speech, included the adjustment of subsidies, moderation of the public sector wage bill, various tax changes, limits on new contracts and new loans, improvements in budgeting, among other measures.

Yet, when viewed against the background of recent fiscal trends, these measures (and the overall Budget itself) cannot be seen as an adequate response to the economic problems facing Ghana. Specifically, the proposed measures do not free up any fiscal space through which social objectives such as accelerating MDG achievement can be pursued.[13] Once wages and debt service are covered in the 2014 budget, the bulk of the remaining resources to finance public investment and operations and maintenance have to be borrowed, even though Ghana is already beyond any prudent debt capacity limit.[14]

Fiscal consolidation and reconfiguration of the mix of debt (to be achieved by more borrowing) are assumed to take place over the medium term. Thus, the Budget effectively leaves the imperative of restoring the economy to a dynamically stable growth trajectory as soon as possible unaddressed.[15]

Box 2: Macroeconomic Management and Governance[16]

Ghana has been praised for its political governance which has made the country a voice of reason and political stability within West Africa. Noteworthy elements include: the return to democratic rule under the 1992 Constitution; the subsequent successful conduct of several national and literally dozens of local elections; the deepening national commitment to Human Rights and empowerment of women; the protection of, and respect for freedom of expression (particularly through the mass media and Freedom of Information Act); and more recently for the seamless transfer of power following the death of President Mills. These accomplishments stand in stark contrast to the arbitrary governance in play prior to 1992.

Yet, few of the improvements in political governance have carried over to economic governance, especially its macroeconomic dimension. Good (or appropriate) macroeconomic governance has two complementary features. The first is that the government spends or allocates the public resources at its disposal efficiently, effectively, and equitably. The second is that the government finances its expenditure through fiscal, monetary and debt management policies that support and sustain rapid, inclusive growth and development.

[13] Recall from the definition given above that fiscal space involves expanding the resource envelope without undermining the integrity of the budget or macroeconomic stability. Too many observers tend to focus on the resource envelope and neglect the qualification.

[14] This is evident from data in the 2014 Budget. Personal emoluments, interest, and payments to designated Funds absorb 79.5% of domestic revenue. Adding to this the retention of IGF by MDAs and transfer of oil funds to GNPC absorbs 94.4% of domestic revenue. Once allowance is made for clearance of arrears (3.1% of GDP) essentially all domestic revenue is required to pay for the above items. The implication is that resources to cover goods and services and capital expenditure have to be borrowed.

[15] The team met with senior Ministry of Finance officials on December 13, 2013 and greatly appreciates the opportunity to better understand the Ministry's thinking about the budget. The team members understand the constraints under which the Budget was framed. Nonetheless, the Ministry's explanations did not change our assessment that the 2014 Budget does not constructively respond to the economy's circumstances. Given the IMF's suggestion that a 6% projected budget deficit would be "insufficiently ambitious" (IMF June 2013, p.11) and the recent Moody's, S&P, and Fitch downgrades of Ghana's debt (Ghanaweb, 2013; Newstatesman, 2013), this assessment is widely shared

[16] This note draws liberally from Hill and McPherson, 2004, Chapter 13.

....

As explained in other Boxes and the main text, successive governments have performed poorly on both counts. With respect to expenditure, Ghana now devotes 16% of GDP to expenditure on personal emoluments and debt service.

This absorbs the major part of tax revenue, and lowers public sector efficiency by diverting resources from operations and maintenance, and investment. The outcome, widely evident throughout Ghana, is low public sector productivity and the inadequate expansion of national capacity to support future growth. The large share of public resources going to wages is inequitable because it inappropriately rewards those who are fortunate to hold a public sector job, a group comprising fewer than 5% of the labor force. Finally, the present pattern of government expenditure is destabilizing because the public sector is being sustained through deficits and debt accumulation well beyond the expansion of the economy's productive capacity. The result is an inflation rate significantly above comparable international levels, high nominal interest rates, progressive overvaluation of the real exchange rate, and persistent balance of payments deficits.

The rest of this study is organized as follows.

Section 1 summarizes the main features of Ghana's recent human development performance. Section 2 discusses the underlying political-economy dynamics that drive some of these outcomes. Section 3 assesses possible scenarios that Ghana could face in the short to medium terms in generating fiscal space to promote inclusive growth and make progress towards the MDGs. Section 4 offers suggestions regarding the short-term adjustments needed to move the economy in ways that accelerates the achievement of the MDGs and fosters sustainable and inclusive human development over the longer term. The study ends with suggestions on how these adjustments to expand fiscal space can be undertaken efficiently.

The report has five major conclusions:

- **One:** There is currently *no* fiscal space to accelerate progress towards the MDGs.
- **Two:** The economy's current trajectory is dynamically unstable meaning that the key macroeconomic variables – the budget, balance of payments, growth of money and credit, exchange rate, debt, rate of consumption, and interest rates – have the economy on an unsustainable trajectory. Fundamental adjustment will be needed to rebalance the economy and move to a stable, inclusive growth path. The recent 2014 Budget proposes some useful changes but does not effectively address this problem.
- **Three:** Ghana's current economic difficulties will not and cannot be rectified by more spending and/or more borrowing.
- **Four:** Rebalancing the economy will require major cuts in expenditure, improvements in revenue generation, sharp reductions in the growth of public sector debt, and a determined focus on raising the efficiency within the public sector.
- **Five:** These actions will need to be supported by fundamental (and long overdue) improvements in macroeconomic management.

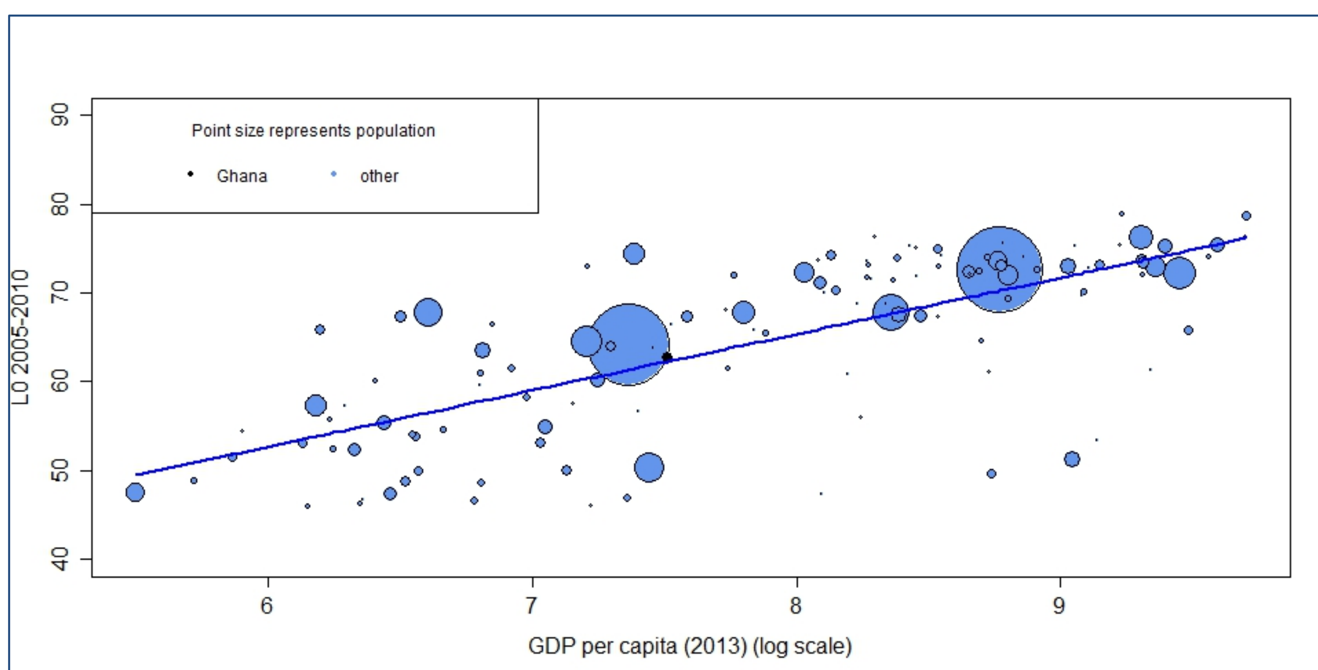
2. Main Features of Ghana's Recent Macro-Fiscal and Human Development Performance

This section presents a snapshot of key current patterns and Ghana's recent trends in socio-economic development. Since many similar reviews exist, we shall be brief paying more attention to Ghana's comparative performance.[17]

2.1 Macro-fiscal patterns and trends

Figure 1 is a cross-section plot of life expectancy at birth against per capita income for all developing countries. Ghana (the black dot in the middle) is a small lower middle-income country with 'average' life expectancy for its level of development. *(Unless otherwise mentioned, the figures and tables reflect authors' calculations based on World Development Indicator data.)*

Figure 1: GDP per capita vs. life expectancy at birth 2005-2013



Ghana's growth performance, particularly over the period 2008 to 2012, has been impressive. Aggregate GDP has grown by 8.6% per annum with per capita income increasing by 5.9%.

Figure 2, which measures the average income growth against per capita income level, shows that Ghana (the red dot) grew faster over the 2008 to 2012 period than LICs (the red open triangle), and LIMCs (the red shaded triangle).

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[17] The data are drawn from several comparative data sets. In some cases, the comparisons cover different, though overlapping, periods.

Figure 2: GDP per capita—2012 level vs. 2006-2012 growth

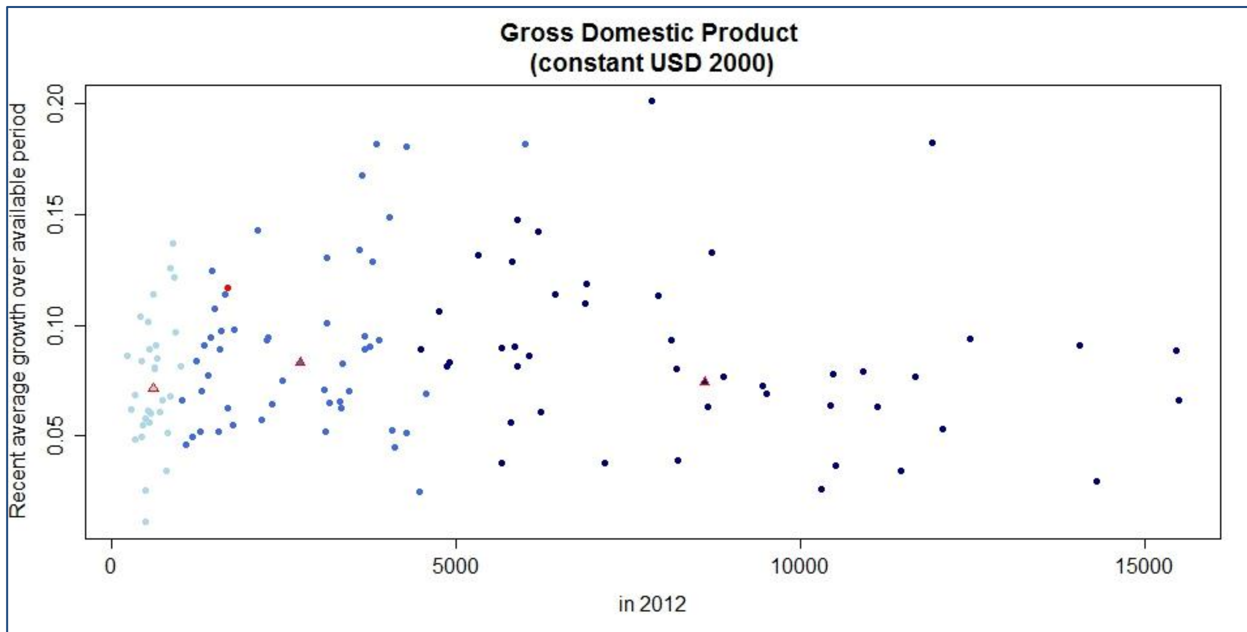


Figure 3: Trends in Consumer Price Index, Ghana vs. 3 income groups, 2004-12

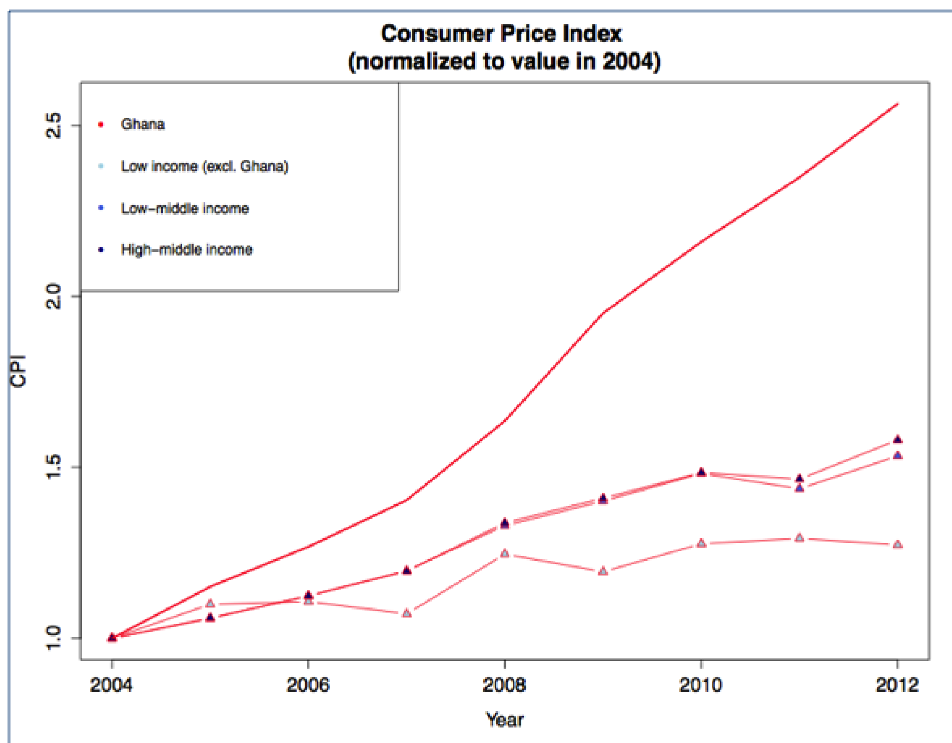


Figure 3 illustrates a different aspect of Ghana's performance. It shows the normalized consumer price level since 2004 for Ghana (the solid red line) relative to low-income countries (LICs), LIMCs and high (or upper) middle-income countries (UMICs).

By all international standards, Ghana's inflation has been abnormally high, undermining incentives to save, adding to the riskiness of investment, and compounding the difficulties of the poor.[18]

Figures 4 and 5 provide perspectives about two of Ghana's perennial and related problems. When compared to LICs and LMICs, Ghana invests an exceedingly low share of its national income. The average for the period 2007 to 2011 was around 17% of GDP. Such a low level of investment, especially during the recent (unprecedented) commodity boom, reflects both the weak capacity of the public sector to mobilize resources and invest them efficiently and the limited incentives for private investors to expand their productive capacity in Ghana.

Figure 4: Total investment as a share of GDP, 2011 level vs. 2007-11 growth

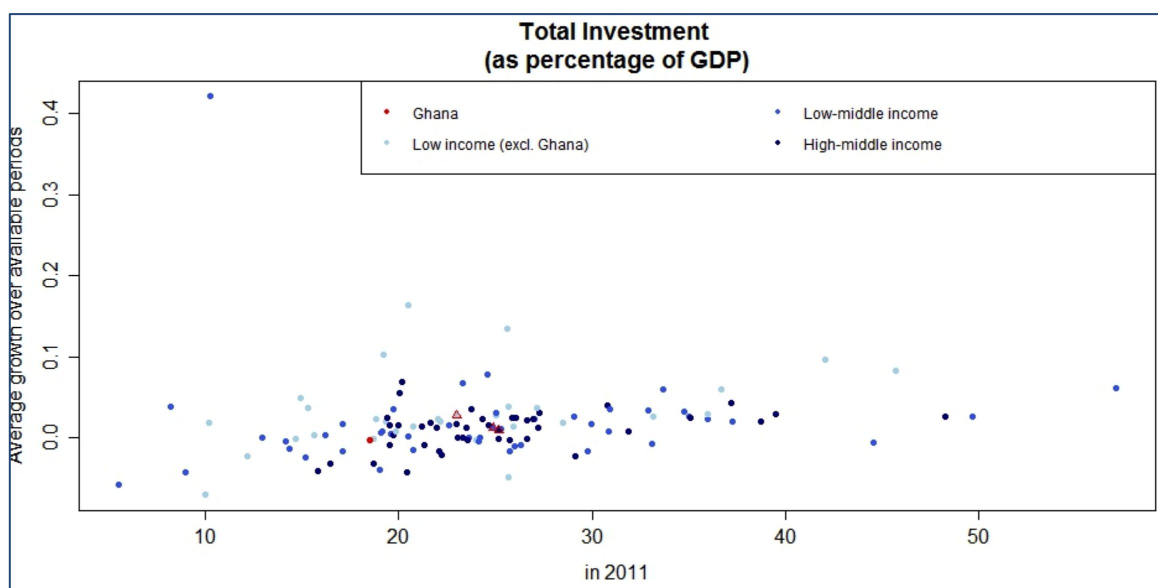


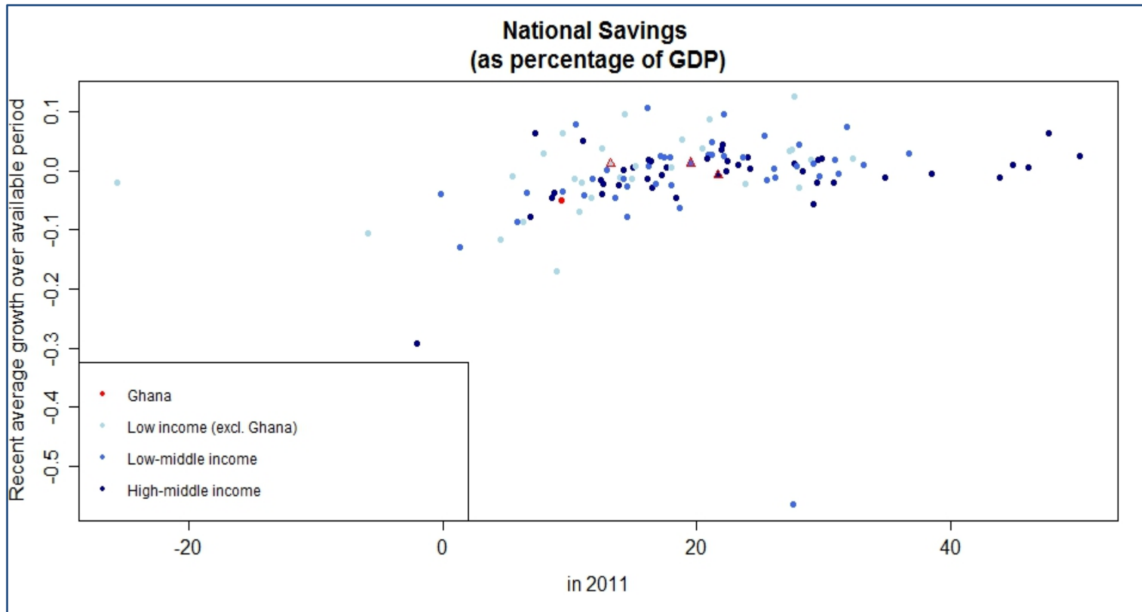
Figure 5 highlights one of the major reasons for low investment, namely, a general unwillingness by Ghanaians (whether in the private or public sector) to forego current consumption, i.e., save: average gross domestic savings over the period 1980 to 2011 was 5.9% of GDP.[19] Even with Ghana's recent economic boom, that rate has remained low.[20]

[18] Inflation is one of the "cruelest taxes on the poor." They have few assets to hedge against the loss of purchasing power; minimal market leverage to raise their earnings or income; limited capacity to store commodities; and they have at best minimal access to foreign exchange to reduce the losses on local currency. By contrast, the better-off members of society have none of these disadvantages.

[19] Data derived from the WorldBankMetaDataSeries_Ghana available on www.worldbank.org (McPherson and Vas, 2013).

[20] National savings are boosted by large remittances (or roughly $2 billion per year). In effect, Ghanaians abroad save roughly the same amount as the local population.

Figure 5: National savings as a share of GDP, 2011 level vs. 2007-11 growth



The performance of government revenue is illustrated in Figure 6 (where Ghana is represented by the black dot), Figure 7 (again, the black dot) and Table 1. Over the period 2007-2011, government revenue increased at an average annual rate of 6%. In this respect, Ghana's performance matches the average revenue effort of LICs and is well above the average revenue growth for LMICs. But, for Ghana to "catch up" to average LMIC "tax effort," the recent rate of improvement in its revenue performance will have to persist for at least another decade

Figure 6: Growth in government revenue as a share of GDP vs. GDP level, 2011 level vs. 2007-11 growth

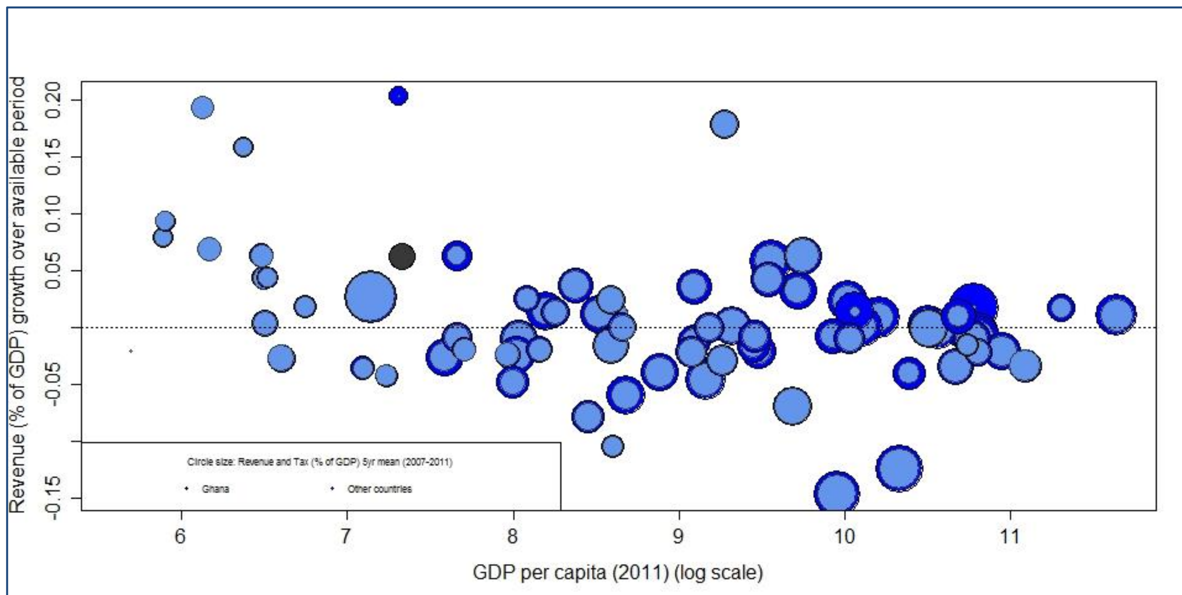
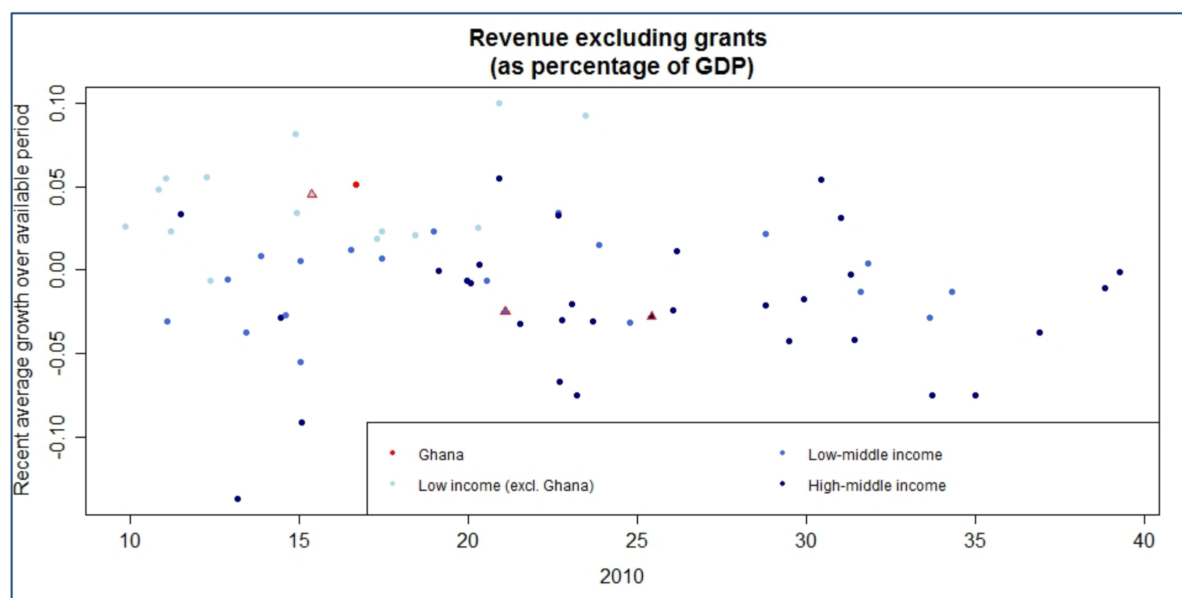


Table 1: Revenue and taxes levels and trends, Ghana vs. three income groups

Category	Average Revenue (% GDP) 2007-2011	Average Tax (% GDP) 2007-2011	Revenue Annual growth rate	Tax Annual growth rate
Ghana	16.6	13.7	6.2	2.0
Low income	13.3	11.5	6.3	4.7
Low middle income (excluding Ghana)	23.4	17.0	0.3	1.9
Upper middle income	26.8	18.6	-1.8	-0.2
High income	34.2	19.6	-1.2	-2.7

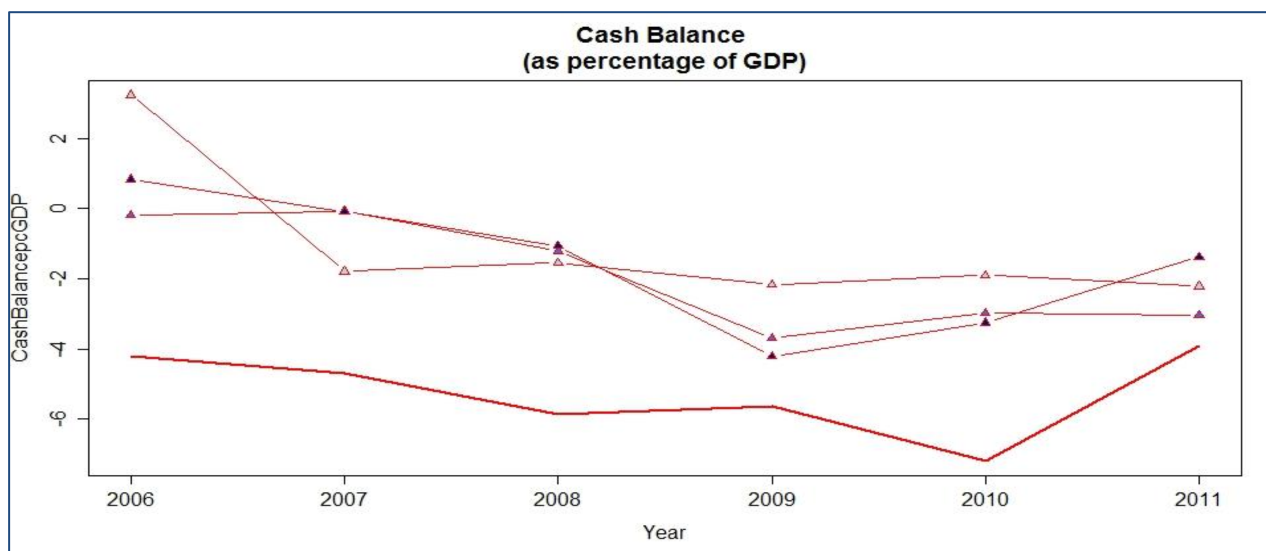
Figure 7: Revenue excluding grants as a percentage of GDP, 2010 level vs. 2006-10 growth



The data in Figure 8 (particularly when viewed together with those in Figures 6 and 7 and Table 1) underscore the large persistent gap in Ghana between government revenue and expenditure (Ghana is the solid red line).[21] As in the case with inflation, Ghana's cash budget deficit is a major negative outlier relative to the average of the principal comparator groups (UMIC, LIC and LMICs in 2011, in descending order).

[21] More recent data would show a major divergence in these graphs. The cash deficit for Ghana was around 9.6% of GDP in 2012 and estimated to be 10.2% of GDP in 2013 (IMF June 2013, Table 2C; 2014 Budget Speech, par. 38).

Figure 8: Cash balance as a percentage of GDP, Ghana vs. 3 income groups



Overall, a key feature of Ghana's recent macro-fiscal performance is the persistence of large fiscal deficits and the corresponding growth of public debt and prices. Budget deficit (including grants) of the GoG was 7.5% of GDP and the debt stock rose from 33.6% of GDP in 2008 to 49.3% of GDP in 2012. In absolute terms, Ghana's debt rose from $10.1 billion in 2008 to $19.1 billion in 2012. It will be over $24 billion at the end of 2013.[22]

As the previous report (UNDP/GoG 2011) noted, this rise in debt has been rapidly and so to speak 'pre-emptively' spending the projected net revenue from the projected 25-year production life of the Jubilee field. Indeed, given that the oil revenues have been significantly lower than originally expected (due to production delays, lower output, rising costs), the run-up in government debt (of $14 billion) has already pre-spent (perhaps) the majority of the oil revenue.[23] This may not have mattered had all of the borrowing been invested in productive capital that supported MDG achievement and promoted human development. .

2.2 Human development performance and imbalances

As is often noted, Ghana has registered broad-based improvement in key social indicators. For example, the Human Development Index (which combines education achievement, longevity and health, and standard of living) was .391 in 1980, .427 in 1990. By 2000, it had risen to .461 in 2000 and in 2012 it was .558.

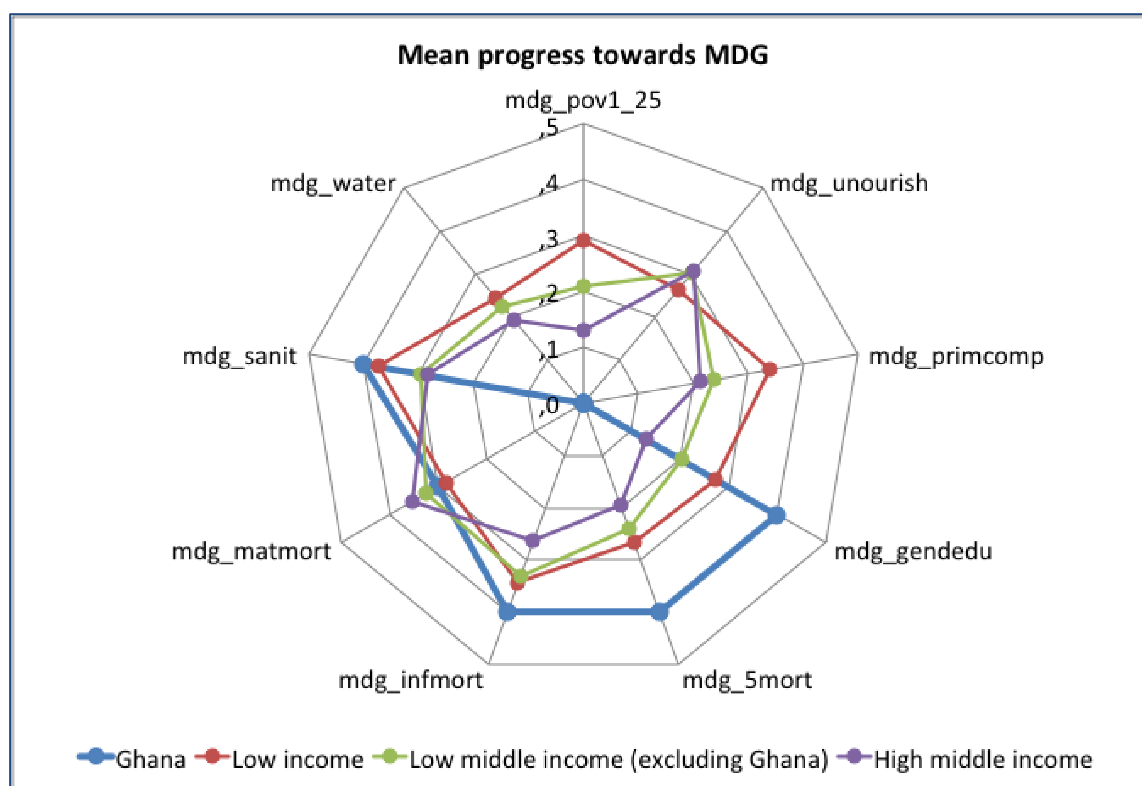
These aggregate improvements were also reflected in Ghana's progress towards the MDGs. Monitoring by the World Bank and UNDP confirms that Ghana has already met 4 of the 9 main indicators.[24] These relate to poverty, undernourishment, primary education and access to water (Figure 9). By contrast, Ghana remains well behind on other indicators such as infant, under 5 and maternal mortality, sanitation, and gender equity. As Figure 9 shows, Ghana has performed significantly less well than LIC and LMICs in these areas.

[22] Budget Speech, November 2013, par. 61

[23] The difficulties have been highlighted by the Minister of Energy (Oteng-Adjei, 2012). They are evident in the revenue data reported in the 2014 Budget Speech, pars. 41 to 43.

[24] UNDP/GoG, 2012

Figure 9: Progress towards major MDG targets



Source: Authors' calculations based on World Bank data. A higher score registers worse/little progress. 0 means that the MDG indicator has been met. This graph can be read as a target, with each point showing the degree to which each MDG is 'off target.'

Another key message is that Ghana's progress against the MDGs is extremely uneven across indicators and regions. There is a highly unusual dichotomous pattern in which some targets have been met and others missed by wide margins. The latter category includes all mortality indicators as well as those related to sanitation and gender.

This pattern reinforces the point that Ghana's recent rapid growth has been inclusive (Annex 2)—both 'vertically' and 'horizontally'. The former refers to traditional socio-economic inequality, measured by the inequality adjusted human development index. For 2012, it was estimated to be .38 or 45% below the unadjusted HDI of .56.[25]

The latter is reflected in the persistence of sharp regional imbalances, especially between the North and South of the country, but more particularly between the Greater Accra Region and other regions. Several dimensions of these regional disparities were evident in comparisons based on the MPI (Multidimensional Poverty Index) reported in the UNDP-sponsored Western Region Human Development Report.[26] The Western Region generates close to 50% of Ghana's GDP yet lags in most measures of human and social development that are captured by the multidimensional poverty index. As that Report shows, the disparities have been exacerbated by the persistently high level of net resource transfers from the Region.

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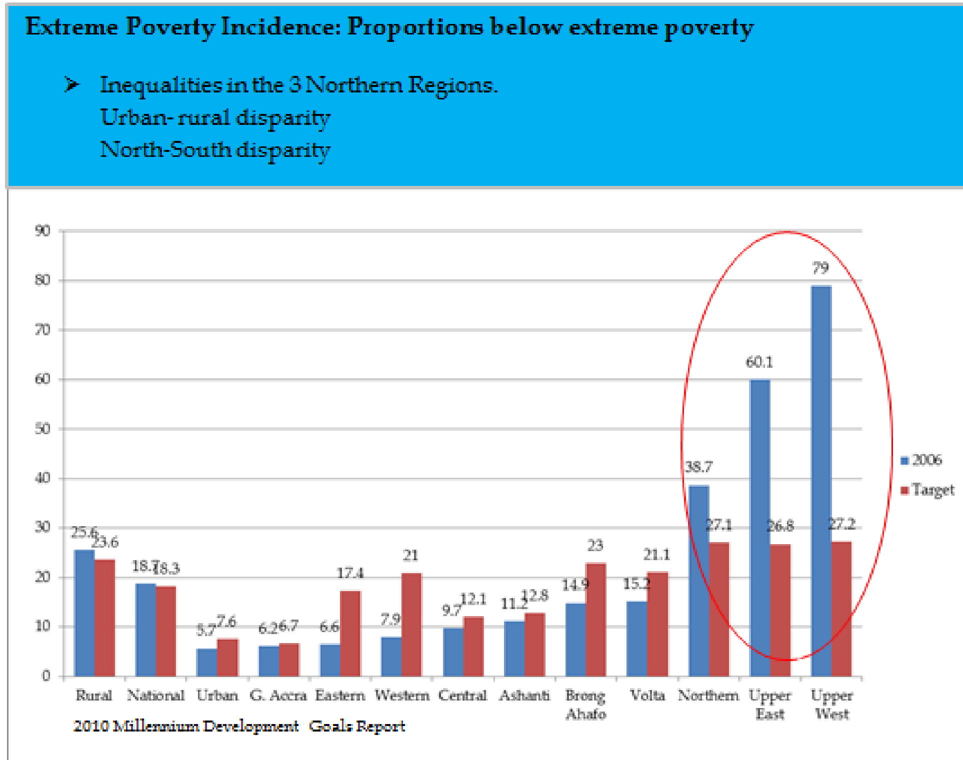
[25] Data from UNHDR stats online

[26] UNDP, 2013

Similar gaps apply to other regions, particularly those in the North. Figure 10 reports the regional performance with respect to the MDG for extreme poverty. The country overall has met the MDG target for halving extreme poverty, yet the rural area as whole and the three regions in the North have missed the target. The gaps in the three northern regions are large.

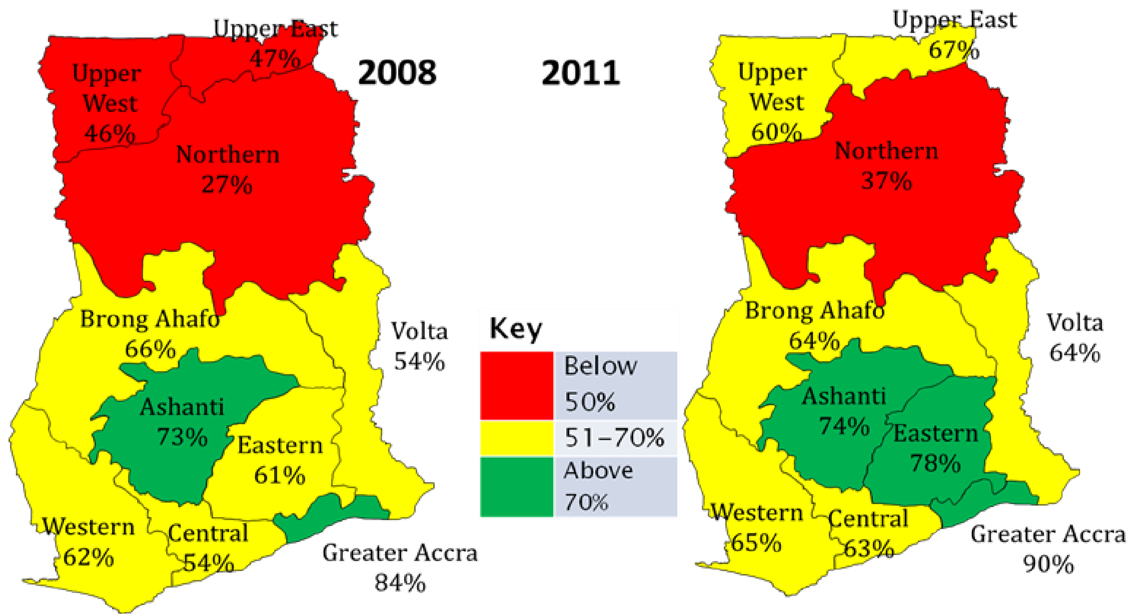
Figure 10: Regional disparities in extreme poverty prevalence in Ghana



These slippages on poverty show up in other MDGs.[27] Figure 11 depicts the situation with respect to child malnutrition (stunting) in 2008 and 2011. Both the Northern and Upper East regions are well behind despite Ghana having met the overall MDG target in this area.

[27] UNDP/GoG, 2012; GoG/UNDP, 2012; GSS, 2013

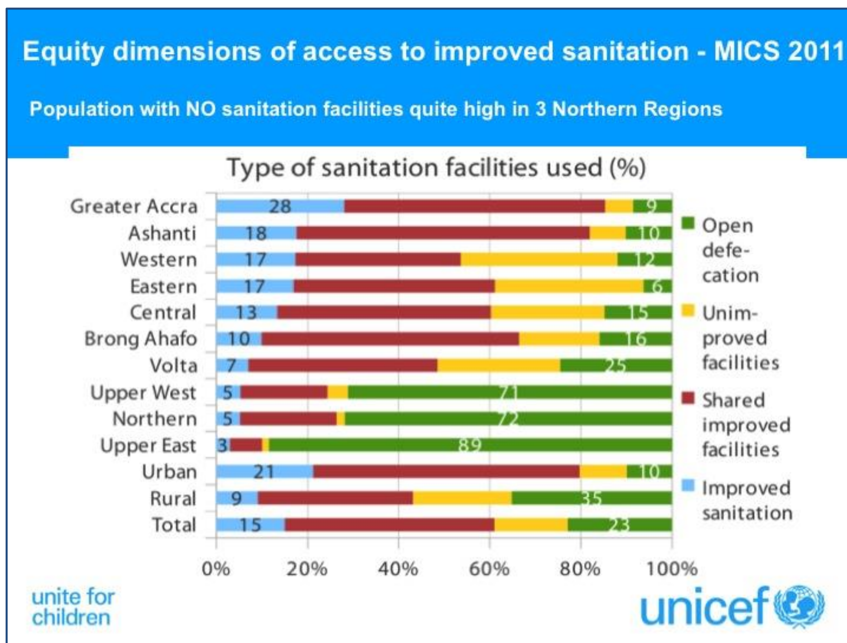
Figure 11: Regional disparities in malnutrition in Ghana



Source UNICEF:

Figure 12 describes the sanitation situation across Ghana for 2011. It illustrates that Ghana is not only well below this particular MDG target but when seen in a comparative context, its performance does not reach that of LICs, let alone the LMICs.[28]

Figure 12: Regional disparities in access to sanitation in Ghana



Source: UNICEF

Further dimensions of MDG-related expenditure are examined in Annex 3.

[28] World Development Indicators, 2012, Table 1.3, pp. 28-30 and World Development Indicators online

The discussion there explicitly notes that the 2014 budget allocation for education, health and sanitation/water all decline in *nominal* terms, implying that for some items, particularly health and sanitation, the *real* cuts are large. A feature of the education expenditure (discussed more generally below) is the distorted allocation among wages and salaries, goods and services, and assets. This will only perpetuate Ghana's increasingly severe recurrent cost problem.

For Ghana to move beyond these distorted expenditure allocations, high persistent deficits, exaggerated levels of debt accumulation, high inflation, and macroeconomic instability, the overall pattern of macroeconomic governance will need to radically change. This will require a willingness to address their underlying determinants, to which we turn.

3. Underlying Proximate Political-Economy Determinants

3.1 Electoral cycles and implications for the budget

Fiscal slippages (i.e., deviations of the actual fiscal outcomes from the budgeted amounts) emanate largely from high 'unplanned' spending by governments and or lower than expected revenues. Two types of fiscal slippages predominate—transitory and permanent (systemic) types. Transitory slippages occur because governments deviate from their originally targeted spending/revenue levels in response to unexpected economic events. These slippages are usually associated with negative economic shocks, so that when the economy recovers, the budget can return to its earlier path. Permanent or systemic fiscal slippages tend not to be countercyclical, but to occur even in good economic times. High unplanned spending usually poses a threat to the management of inflation and macroeconomic stability. Indeed many authors have attributed the Arab spring, at least in part, to economic factors, including the rising cost of living, rampant corruption, and widening income inequality.[29] While fiscal slippages are often the outcome of shocks and economic mismanagement, it has been widely argued that in sub-Saharan Africa political instability has played a major part in creating budget deficits.[30] Election swings are often accompanied by major shifts in the fiscal balance. This phenomenon, known locally as "election-yearing" has been economically destabilizing.

Ghana's political history was characterized by a high degree of political instability in earlier years. The return to constitutional democracy changed that with Ghana becoming a "haven" of political stability within the broader sub-region.[31] That stability, however, has also been associated with large persistent fiscal deficits, particularly since 2006. The deficits are now structural and are large even when the economy grows rapidly. Earlier studies indicated that the large fiscal deficits in the 1990s could be explained in part by the electoral cyles.[32] That pattern has been re-confirmed over the last two elections (2008 and 2012). To date, it has typically taken almost two years to overcome the effects of the large deficits in election years, with major losses to the real sector. Unfortunately, just when the economy appears to be recovering, another election occurs. We explore how *"politics has been wrecking the economics"*[33] by examining the data more closely.

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[29] Gao, 2012

[30] Easterly and Levine, 1997

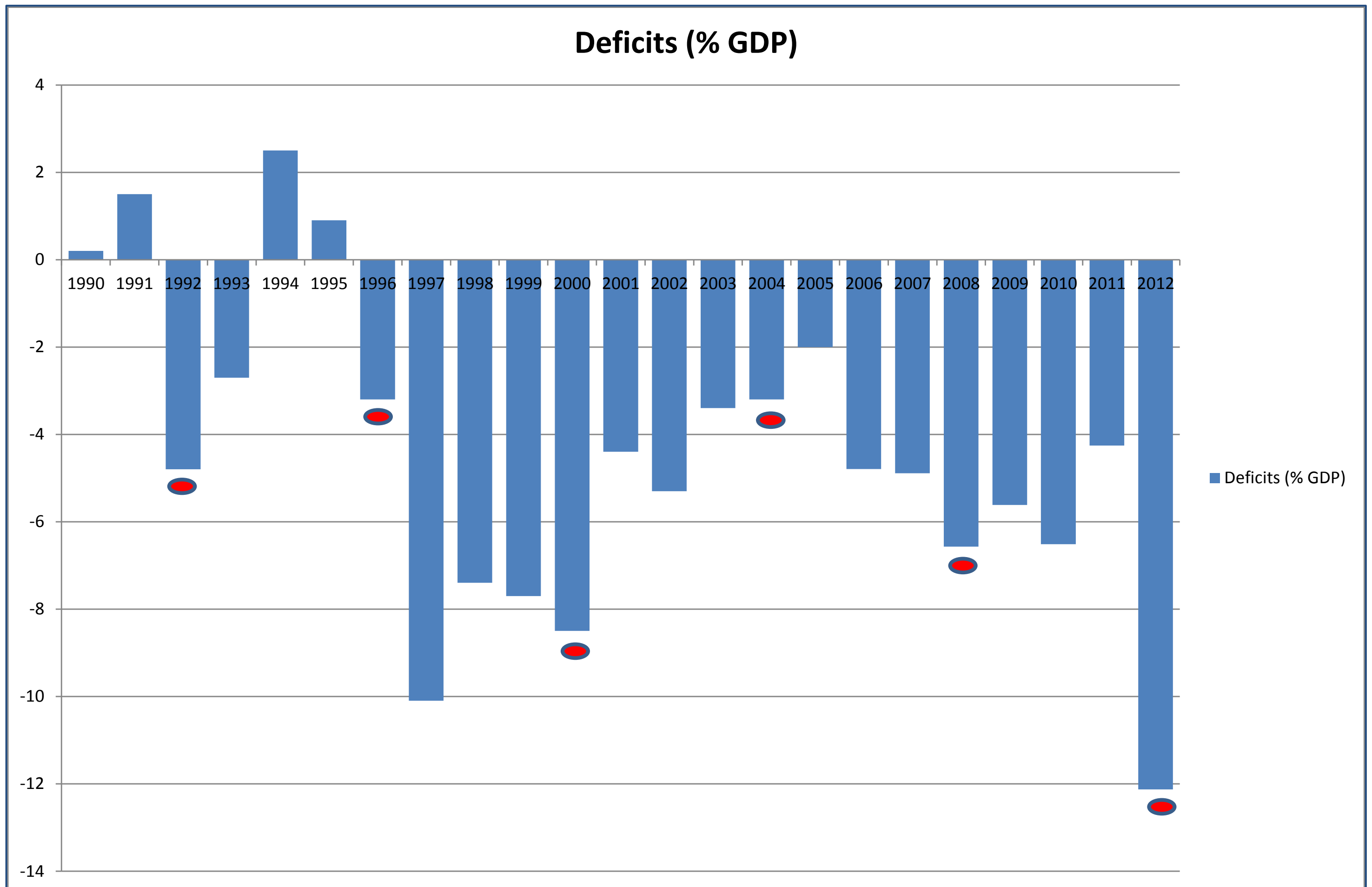
[31] Hirsch, 2013, Pollack, 2011

[32] Addison and Osei, 2001

[33] Comment from the Chair at launch of "State of the Ghanaian Economy in 2012", ISSER, University of Ghana, September 24, 2013

Figure 13 below illustrates the deficits between 1990 and 2012 (with election years marked with a red dot). The pattern of election year excess is repeated except for 2004. In that year, Ghana was in the process of restructuring its debt under the HIPC initiative. All politicians (both governing and in opposition) recognized that any slippage before the "completion point" was reached in 2005 would jeopardize the country's chances of successfully restructuring its debt. Maintaining prudent economic management was both politically and economically astute.

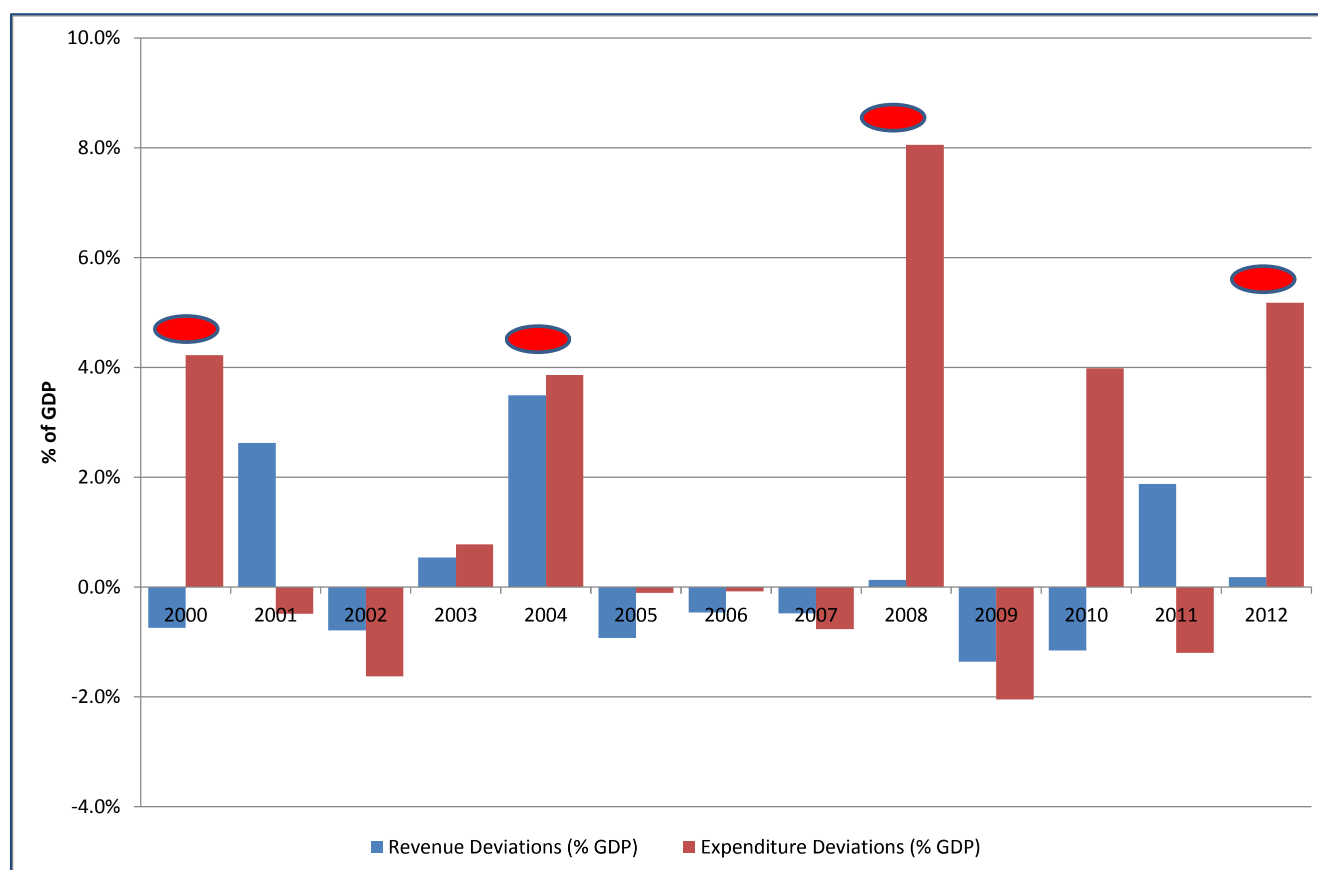
Figure 13: Trends in fiscal deficits and 'election-yearing' for Ghana, 1990-2012



Source: GoG

When the broad sources of the fiscal slippages in the election years are examined more closely (Figure 14), the data show that they have largely been driven by government spending: major fiscal slippages (i.e., 2000, 2008 and 2012) have resulted primarily from higher than planned *expenditures*. Indeed, in all years of high deficits, the deviation in revenue has been less than one percent of GDP. By contrast, the expenditure deviations reached around 8% of GDP in 2008 and 5% of GDP in 2012.

Figure 14: Expenditure and revenue deviations from the budgeted amounts, 2000-2012 (% of GDP)



Source: GoG

A more detailed examination of government spending items (based on data in the following table) shows that there are three areas that have created particular difficulties for Ghana over the last few years.[34]

The first is the public wage bill. Personnel emoluments absorb 28% of total government spending. When spending on wages is related to government revenue or GDP, Ghana is significantly out of line with comparator countries. It is worth noting that Ghana has always allocated a high share of its government spending to wages.[35]

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[34] The IMF Article IV Report (June 2013, Table 2B) noted that expected government revenue and expenditure for 2013 were, respectively, GHc 18.4 billion and GHc 24.9 billion for a cash deficit of GHc 6.9 billion, or 7% of GDP. The 2014 Budget (pars 35, 36) projected 2013 revenue at GHc 20.8 billion and expenditure of GHc 29.7 billion for a cash deficit of 10.2% of GDP. (Arrears in both years are estimated to be around 3% of GDP.) While revenue was higher than budgeted by GHc 2.4 billion, expenditure exceeded the budgeted amount by GHc 9.1 billion. This continues the pattern noted in Figure 14 of expenditure having the largest upside discrepancy.

[35] The wage bill is currently above 10% of GDP and, according to IMF projections in its June 2013 Country Report, expected to remain at that level. This level far exceeds that in comparator countries. Evidence provided by Schiavo-Campo, Tommaso and Mukherjee (1999, p.7) and Clements *et al.* (2010, Table 1) show that across Africa in the 1990s (21 countries sampled) government compensation averaged 6.7% of GDP and in the 2000s (41 countries sampled) it averaged 6.5%. World-wide, government wage bills averaged 5.4% of GDP during the 1990s. During the period 2000-2008, they averaged around 6% of GDP. All of these data confirm that Ghana is an outlier with

In this respect, the wage bill has been a reason but not the only reason for the *worsening* fiscal problem. It can further be argued that the so-called 'Single Spine Salary Scale' (SSSS) is not, in itself, responsible for the recent increase in the wage bill (Box 5). The issue is that the Single Spine has been introduced in a way that was inconsistent with the principles outlined in the GoG 2009 White Paper. The reasons for this have been structural, with deeper political economy roots that are discussed further below.

A second, and the most important, source of the fiscal problem in recent times is the increasing government debt service, particularly domestic debt. The domestic debt repayment plus interest payment on this debt now absorbs about 37% of total government spending.

The final major source of the fiscal debt has been the arrears, which persist and have been catching up with government. In 2012 for instance, arrears clearance absorbed about 16% of total spending. The same occurred for 2013 and is projected for 2014. The implication is that around 15% of the previous year's budget is being carried forward to pre-empt current expenditure.

None of these expenditures can be easily reduced, at least in the short term. Adding the statutory component of the budget to personnel emoluments and the repayment on domestic debt, the total comprises 79% of government spending. This imposes major rigidities on the government fiscal system highlighting the structural nature of Ghana's deficit problem.

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respect to this metric. Additional historical data reinforcing this point are available in Goode (1984), Lienert and Modi (1997), and Kiragu and Mukandala (2003).

Table 2: Share of total expenditure by category 2004 to 2012

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012
ITEM									
Discretionary	68.8	57.8	71.2	71.5	75.3	73.5	73.5	67.5	78.3
Personal Emoluments	24.2	20.8	26.2	23.3	20.8	26.7	24.0	31.6	28.2
Administration & Service	8.2	8.7	0.0	9.3	6.8	6.7	7.3	5.3	5.6
Administration	5.0		7.0	6.7	4.3	4.7	0.0	0.0	0.0
Service	3.2		2.9	2.6	2.5	2.0	0.0	0.0	0.0
Total Investments	20.2	18.0	12.2	20.4	20.1	20.6	23.9	26.9	19.5
Domestic Financed	4.2	2.4	0.0	8.4	10.5	3.1	8.6	14.4	10.3
Other Cash Expenditure	3.5	2.2	0.0	0.0		0.0	2.7	4.1	4.4
Net Lending	0.6	0.2	0.0	0.0		0.0	0.0	0.0	0.0
Foreign Financed	16.1	15.6	12.2	11.9	9.6	17.5	15.3	12.5	9.2
VAT Refunds (Tax)	0.2	-0.3	0.3	0.4	0.3	.3	-0.3	-0.7	-0.7
Arrears Clearance	0.9	2.9	0.6	0.0		0.0	0.0	12.0	16.2
Utility Price Subsidies	7.7	1.1	6.2	0.1	0.2	0.0	1.0	0.0	0.8
HIPC Financed Expenditure	6.5	5.1	4.1	3.3	1.9	2.2	1.8	0.0	0.0
MDRI Financed Investment	0.0	0.0	0.0	3.0	1.0	0.9	0.6	0.0	0.0
Outstanding Liabilities	0.0	0.0	1.1	1.3	1.5	6.7	-4.8	-13.5	-15.5
Reserve Fund	0.0	0.0	0.0	3.2	4.9	1.8	3.6	2.4	4.5
Other Transfers	0.0	0.	0.0	8.0	8.7	8.3	8.1	9.9	10.1
Repayment of Domestic Debt	0.0	0.0	0.0	0.1	4.6	0.0	16.2	14.5	29.2
Divestiture Liabilities	0.0	0.0	0.0	0.0	3.1	0.0	0.0	0.0	0.0
Discrepancy (Items in Transit)	0.9	1.4	0.4	-0.8	1.4	-0.7	3.1	0.5	-4.1
Total	68.8	57.8	71.2	71.5	75.3	73.5	73.5	67.5	78.3
Statutory Payments	31.2	42.2	28.8	28.5	24.7	26.5	26.5	32.5	21.7
External Debt service	9.9	9.5	7.5	7.2	7.3	7.7	6.2	6.5	5.0
Principal	6.7	6.9	5.4	5.3	5.2	4.9	3.8	4.3	2.6
Interest	3.2	2.6	2.1	1.9	2.1	2.8	2.4	2.2	2.4
Domestic Interest	8.9	6.9	7.0	5.3	5.1	8.3	8.5	9.6	7.9
DACF	2.6	2.5	2.4	2.4	2.6	1.7	3.1	4.6	1.7
Transfer to Households*	4.5	8.8	6.9	4.7	3.8	4.4	3.3	5.6	2.2
Education Trust Fund	2.9	2.6	2.5	2.4	2.7	1.5	1.8	2.3	1.5
Road Fund	2.2	2.4	2.5	1.7	2.1	1.3	0.9	1.0	0.8
Petroleum Related Fund	0.2	0.1	0.1	0.0	1.1	0.0	0.0	0.1	0.0
National Health Fund	0.0	0.0	0.0	4.8	0.0	1.7	2.6	2.8	2.5
Sub-Total	31.2	42.2	28.8	28.5	24.7	26.5	26.5	32.5	21.7
Total Expenditures	100	100	100	100	100	100	100	100	100

Source: GoG

3.2 An Assessment of the 2014 Budget

We review the 2014 budget from the starting point that the fiscal situation of the country remains dire with minimal scope for creating fiscal space. The terms available for Ghana for foreign capital inflows are changing in an adverse way and, as already noted, foreign aid is on a downward trend. The country's debt situation is worsening and, in the process, imposing further rigidities on the budget. There are also signs of increasing misalignment of the exchange rate, evident in recent relative sharp divergence between the inter-bank rate and that of the forex bureaus.

Box 4: Is the single spine salary scale to blame?

As noted in the Government White Paper (2009), the Single Spine Salary Scale (SSSS) was designed to (1) overcome distortions and inequities in the public sector wage structure through means that would (2) not have an adverse impact on the budget, (3) maintain macroeconomic stability and (4) directly link work productivity to remuneration. Thus far, goal (1) has been addressed despite some continued dissatisfaction with wage relativities but goals (2)—(4) have remained untended.

Despite the recent increase in the wage bill, it is worth noting that Ghana's problem is *not* the Single Spine or any other way the GoG may have chosen to re-structure the public service wage structure, including leaving the pay scale as it was.[36] The fundamental problem appears to lie in the mode of implementation. Public sector workers appear to have taken the opportunity offered by reform of the "salary scale" to claim a higher share of national income as wages and benefits. This has had an adverse impact on Ghana's fiscal space while intensifying inequality. It specifically exacerbates the "insider/outsider" division reducing the degree of inclusiveness within Ghanaian society. The pre-emption of a growing share of national resources in personal emoluments (11.9% of GDP in 2011, 10.5% GDP in 2012, and 11.2% in 2013, with an average of 10.4% of GDP expected over the period 2013 to 2018) continues to divert resources from expenditures that would otherwise help the country achieve the MDGs.[37]

As noted in a recent IMF report (IMF, 2013 p.8), fiscal consolidation and a shift in the composition of spending from wages and subsidies to investment are needed to support growth, reduce external pressures, and maintain debt sustainability. The IMF explicitly noted that failure to control the public wage bill was the key driver behind the larger deficit. Recurrent spending rose by 4.25 percentage points of GDP between 2011 and 2012, reflecting higher interest cost, energy subsidies, a much larger wage bill, which was greater by 47 percent in nominal terms. An 18 percent pay hike explains part of this increase, and new hiring appears to have offset the smaller-than-expected savings from the recent payroll audit. In addition, deferred wage payments form the single spine salary reform amounted to 2.5 percent of GDP, twice the level included in the mid-year revised budget. None of these wage adjustments has been related to improvements in productivity. The reality is that Ghana has too few resources to support such a large public sector wage bill, particularly when public sector productivity is effectively so low.

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[36] Within Government, views differ regarding the contribution of Single Spine Ghana's fiscal difficulties, especially whether the Single Spine adjustment contributes to the expansion of the wage bill and to wage arrears. During the study team's meeting with Ministry of Finance officials, the problems they cited included the costs of migrating to the single spine (since no employee's wage was allowed to decline), the various arbitration judgments which have accompanied the exercise, and the push by different constituencies and unions to include benefits in the wage. The problem with blaming the single spine *per se* is that all of these except the costs of migration would have been incurred with the old pay structure.

[37] IMF, June 2013, Table 2C

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The latter is aggravated by the totally inadequate and delayed release of resources for operations and maintenance a practice which, as noted elsewhere in this paper, accentuates government 'inefficiency' by intensifying the recurrent cost problem. In dynamic terms, the GoG is in a bind. The wage bill drives part of the budget deficit and the accumulation of debt. And, because there is little room or willingness to cut other items of expenditure (especially capital, interest charges, and recurrent costs needed to support government operations), this situation continues. Unable to raise revenue to cover the additional spending, the GoG borrows heavily with gross debt at the end of 2013 above 50% of GDP and heading higher.

At one level, the Government appears to have recognized these macroeconomic challenges which accounts (in part) for the theme for the 2014 budget: *"Rising to the challenge: Re-aligning the Budget to meet Key National Priorities."* The Budget seeks to create additional fiscal space through a variety of policies aimed at improving revenue mobilization (with an increase in the VAT rate), enhancing the efficiency of public expenditures by realigning key budget items especially focusing on completing projects which are in the pipeline, and restructuring of the public debt by extending the term of the debt. These intentions are highly positive and headed in the appropriate direction.

Unfortunately, the steps discussed in the 2014 budget do not go far enough in dealing with the current macroeconomic difficulties. The key problems are as follows.

1. The budget projects an overall cash balance of 8.5% of GDP in 2014, a decrease from the 2013 ratio of 10.2% of GDP. Looking closely at the budget items, one may note that the increase in the expenditure in 2014 will match the increase in nominal revenue. The implication is that the expected improvement in the fiscal balance (i.e., the reduction in the cash deficit) will come from output growth. However, the level of the fiscal deficit actually increases by GHc 65.3 million over the 2013 outturn. In addition, a significant portion of the fiscal improvement in 2014 is associated with increased arrears. Specifically, non-road arrears are to increase by about GHc 607.5 million in 2014, an increase of about 31% over the 2013 level of arrears. That is, fiscal improvements will come either with the accumulation of debt or from output growth.
2. A critical area of public financial management in Ghana has to do with the rigidities engendered by many statutory funds in the government budget, a factor that is increasingly being raised within policy discussions. For 2013, there were as many as five 'funds' that absorbed around 10% of total government spending. These funds, established by law, add to the inefficiency of public spending on a number of fronts. They increase the rigidity of the budget making it difficult for budget managers to react to shocks within the year. They impose additional costs (for fund management) on the general administration of the government. In view of these costs and the rigidities they create for public financial management, the implications of the additional two funds proposed in the 2014 budget need to be considered. .
3. The budget proposes to tackle the current debt problem by restructuring the debt, specifically its time profile. In general, debt restructuring is beneficial if the short term savings engenders benefits (i.e., costs savings) which outweigh any future burden of the debt. The strategy proposed in the 2014 budget is to borrow longer term loans from abroad to pay down short-term domestic debt. Under current conditions, this form of debt restructuring may not confer tangible savings on the economy. Now that Ghana is a lower middle income, it does not have access to concessional financing. Moreover, with the recent debt downgrades and the size of Ghana's existing debt, further attempts to borrow abroad are likely to meet significant resistance, let alone incur substantially higher rates.[38]

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[38] There is confusion regarding the potential savings which will result. Ghana will be borrowing in foreign exchange to pay down domestic (cedi) debt. There will be projected savings only if the respective interest rates are

Based on these arguments therefore, the analysis in this paper would suggest that the current budget is not ambitious enough to tackle the current macroeconomic stability challenges.

4. Possible Future Scenarios

4.1 Assumptions and limitations of the optimistic business-as-usual scenario

A 'business-as-usual' scenario is fully articulated and described empirically in the most recent IMF Country Report (2013, Tables 1, 2A, 2C, 3 and 4). Projections cover the period 2013 to 2018 for GDP and its components, the Government Budget, the monetary survey and the balance of payments. The projections assume that Ghana will continue to grow at an annual average rate above 6%. It is also assumed that annual gross capital formation will exceed 20% of GDP and consumer price inflation will decline to around 7% p.a. The budget deficit is expected to average 6.4% of GDP (Table 2C), the balance of payments current account deficit will average 9% of GDP, and base money will increase by an average of 19% p.a. Gross government debt is expected to continue rising to a peak at 54.8% of GDP in 2017. The projections are upbeat with Ghana experiencing high rates of economic growth despite unremittingly large budget and balance of payments deficits. Moreover, even though the debt/GDP ratio will remain above 50%, issues of debt sustainability are assumed not to arise. The projections are summarized in table 3.[39]

Table 3: Ghana's government macro-fiscal projections 2013-18

	2013	2018	Ave. 2013-2018
Growth of real GDP 7.9	8.0	6.3	
CPI (% annual average)	10.8	6.9	8.1
Base money (% increase)	24.0	15.3	18.8
Broad money (% increase)	27.8	18.5	21.5
Gross Capital Formation (%GDP)	20.3	21.3	20.8
National Savings (% GDP)	8.5	13.9	11.8
Curr. Acc. Balance (BoP % GDP)[40]	-11.9	-7.4	-9.0
Trade Balance (BoP % GDP)	-11.6	-7.2	-9.2
Reserves (months import cov.)	2.5	3.8	3.1
Government Revenue (% GDP)	20.5	22.2	21.2

compared on equal terms. This requires comparing the foreign and local rates of interest after adjusting for expected changes in the exchange rate (and market risks). Given recent changes in the exchange rate and the widespread expectation that the economy's macroeconomic difficulties will continue, foreign borrowing to restructure domestic debt is not the bargain portrayed in the Budget Speech (pars 12 and 89).

[39] IMF June 2013, Table 1, p.26

[40] Including official grants.

Tax revenue (% GDP)	17.5	20.3	19.0
Government Expenditure (% GDP)	27.8	28.3	27.6
Comp. of Employees (% GDP)	10.0	10.7	10.6
Interest on debt (% GDP)	3.6	4.2	3.9
Budget deficit (% GDP)	-10.0	-6.2	-7.3
Government debt (gross, %GDP)	51.4	54.8	53.2
Donor support (%GDP)	3.6	1.5	2.3

Source: GoG reported in IMF, June 2013

These data provide a coherent picture of an economy with absolutely no buffers against negative shocks. This is very worrying given the debatable assumptions used to derive the projections, notably the notions that:

1. growth will remain high despite relatively low investment (no Asian country has ever sustained such high average growth with an investment rate of 21% of GDP.)[41]
2. inflation will decline despite the continued rapid expansion of base money and broad money;
3. the trade deficit (which is expected to remain above the GDP growth rate) will be financed by capital inflows.;
4. government revenue will continue rising as a share of GDP despite a halving of donor support, with sharply higher tax effort being expected to make up the difference.
5. the compensation of employees and interest payments will dominate government expenditure (absorbing 68% of government revenue).
6. the stock of foreign exchange reserves is projected to rise from 2.5 months to 3.8 months of import coverage. This represents an absolute increase in $5.2 billion, a target that will be easily met *if* the foreign exchange deposits in local banks rise by the projected $16 billion.[42]
7. the gross government debt as a share of GDP rises only slightly over the five-year period (from 51.4% in 2013 to 54.8% in 2018).

This scenario requires that nothing untoward or unexpected impedes the economy or intervenes to disrupt the expected trends. Tax effort will increase, exports will remain robust (indeed they will grow more rapidly than imports even though the commodity super-cycle has ended), the exchange rate will not experience any pressure as Ghana becomes more indebted, the debt dynamics will not turn adverse despite the persistence of high nominal interest rates and rising interest payments.

[41] The implied incremental capital output ratio is 3. This is inconsistent with Ghana's historical performance. During the 1980s, the incremental K/O ratio was around 4.3; it increased to 5 in the 1990s; and from 2000 to 2010 was 3.9 (WDI, 2012). The World Bank MetaDataBase reveals that the incremental K/O ratio for the whole period 1980 to 2010 was 4.3. By contrast, the incremental K/O ratio for all lower middle income countries (with an average investment rate of 25% of GDP) for the period 2000 to 2010 was 4 (Source: WDI, 2012, Tables 4.1, 4.8).

[42] There are no indications in the document regarding the expected movements in the foreign exchange rate needed to induce asset holders to accumulate such a large additional amount of dollar-denominated bank deposits. The assumption seems to be that the real exchange rate remains constant implying that it will depreciate by roughly 6% p.a. (the 8% projected CPI inflation minus 2% international inflation). This rate is inconsistent with recent (much higher) rates of depreciation.

It also assumes that foreign remittances and capital inflows will continue uninterrupted, and the economy will move smoothly beyond its current low holdings of international reserves to a more robust coverage of close to 4 months of imports. A further presumption is that continued high growth of base money and bank credit (stimulated by persistent budget deficits) will not cause inflation to accelerate or provoke a flight from local currency.

The IMF appears to be aware that some of its assumptions are too generous. It specifically acknowledges the "stability risks" which confront Ghana[43] and re-stresses the urgent need for sustained fiscal consolidation. [44] Yet, since the projected deficit remains at 6% of GDP, it is obvious that the IMF itself does not expect any meaningful fiscal consolidation to occur.

One problem with the straight-line projections upon which the above scenario is based is that shocks always occur. For a start, there is an election in 2016, which, if it follows the pattern described earlier, will see a major increase in the deficit and an exaggerated build-up in arrears. A further likely development will be that imports (contrary to the IMF projections) will grow more rapidly than exports.[45] This outcome is almost certain given the weakening of international markets for Ghana's exports and the boost to import demand from the high government wage bill and continued public dissaving. Should this occur, the balance of payments deficit will increase adding to debt and pressure on the exchange rate.

Another potential outcome could be a sharp reduction in the growth rate, the result of a continued weaknesses in the prices of key exports (gold and cocoa)[46] and lower economic activity (due to falling productivity in the public sector, further disruptions to electricity supplies, drought and/or floods, and/or a decline in private investment associated with rising uncertainty). Given the current structure of Government debt and the persistent deficits, any significant reduction in the growth of GDP would push the debt ratios to levels that leave little doubt about debt sustainability.[47]

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[43] IMF, 2013, p.1, par. 6, p.7, and Appendix I

[44] The IMF leaves little room for misinterpretation: "…irrespective of feasibility, the mission viewed a deficit target of 6 percent of GDP as insufficiently ambitious" (IMF, 2013, p.11).

[45] From 2008 to 2012, exports and imports grew at the same annual rate (12.8%) but since imports are 47% of GDP and exports are 33% of GDP the absolute gap between them (and hence the financing requirement) has widened.

[46] Current problems are that the price of gold and the supply of cocoa are both low.

[47] The technical nature of analyses of "debt sustainability" provides a false sense of security. For example, the recent IMF Country Report contained a section entitled "Debt Sustainability Analysis – Update" (May 29, 2013). It stated: "The analysis suggests that Ghana's risk of debt distress has risen, but remain moderate." The principal indicators are the present value of debt to GDP ratio, PV of debt to revenue ratio, and the PV of debt service to revenue ratio. All of these are judged by IMF staff to be within sustainability norms. These same metrics are widely used (Roubini 2001; Lukkezen and Rojas-Romagosa 2012). Ghana's policy makers, however, should not take too much comfort from the raw statistics. As Lukkezen and Rojas-Romagosa (2012) note debt sustainability is fundamentally related to perceptions and expectations. As many countries, much better endowed than Ghana, have found over the last several decades, they are creditworthy with sustainable debt burdens until they are not. Prominent examples in the 1980s and 1990s were Mexico and Brazil. So were the Asian countries (Indonesia, Thailand, Philippines) during the late 1990s. More recent examples have been Ireland and Spain. The challenge for all debtor countries is not to push their debt metrics beyond limits that generate adverse expectations about sustainability. Parenthetically, this is the main message of the recent IMF (December 2013) guidance for "debt limits in Fund programs with low-income countries." Ghana's recent debt downgrades suggest that those limits are close at hand.

These doubts have already arisen with the recent debt downgrades of Ghana's debt by Fitch, Moody's and S&P. This would add further downward pressure on the exchange rate and with the projected growth of base money (driven by deficit spending) local interest rates will increase. That change would accentuate an adverse debt cycle in which the GoG would be borrowing to service its debt.

A further shock could arise if the Government seeks to bring the budget under control by cutting the public sector wage bill. Public sector workers are likely to react. Although their reaction will have little tangible impact on public sector productivity, which is already low, their resistance to either wage cuts or lay-offs will disrupt private sector activity and compound the doubts investors have about the economy's future trajectory.

None of these developments will help the GoG expand the social spending and activities that contribute to the achievement of the MDGs. Moreover, the distorted nature of growth across Ghana (evident in the Gini coefficient and regional disparities in key social indicators) is such that a decline in aggregate growth will have a disproportionately larger negative impact on welfare (and hence inclusiveness) outside the Greater Accra Region.

4.2 How things could unravel

Ghana's economy remains at risk of one or more of the following scenarios:

1. The Government's budget deficit (including arrears) may be larger than anticipated, as a result of higher recurrent expenditure (mainly on personal emoluments and debt service) and a less than anticipated rise in revenue (potentially including a faster than expected cut in external support).
2. The balance of payments deficit may widen due to the rapid rise in imports (spurred by rising domestic income, increasing inequality and the persistence of the overvalued exchange rate), the continued softening of exports, a slow-down in capital inflows, and a reversal in short-term financial flows in anticipation of further downgrading of Ghana's debt.[48] Remittances could also level off or begin to fall.[49]
3. The anticipated expansion of oil production (once projected by the Ghana National Petroleum Corporation to reach 600,000 bbl per day by 2018), might be further delayed.[50]

[48] World Bank sources indicated Ghana has been on "debt watch" status for more than a year. Highlighting emerging concern over the rapid increase in Ghana's debt and the failure of the government to take tangible steps to deal with the problem, Fitch which in 2012 had rated Ghana B+ for its "robust economic performance and strong growth outlook" recently downgraded the debt to B (Reuters, 2013). In December 2013 Moody's and S&P also downgraded Ghana's debt.

[49] Remittance inflows have risen significantly over recent years, to an estimated $2 bn in 2012. Evidence suggests that they have boosted household consumption and supported education, weddings and funerals (Sam, Boateng and Oppong-Boakye, 2013). Remittances also appear to be counter-cyclical (Dogbevi 2013) acting as a cushion in an economic downturn.

[50] Several reports on Ghana by international agencies, including KPMG (2013), noted that oil production was expected to reach 120,000 bbl/day by 2013 and 600,000 by 2018. The latter datum was provided by the Ghana National Petroleum Company. These estimates appear to have been overblown. Tullow Oil had hoped that Jubilee would produce 120,000 bbl/day by 2011. It had only reached 110,000 bbl/day in 2013 (KPMG 2013). A comprehensive briefing by the Minister of Energy (Oteng-Adji, 2012) offered no such prospect that Ghana would attain these elevated levels of production.

Ghana has already had difficulty bringing the production of the Jubilee Field up to its expected capacity,[51] and using gas that is now being flared for electricity generation has taken longer than planned.[52]

4. Inflation may not fall from its current double-digit level (inflation was equivalent to 13.2% p.a. in November and 13.5% in December, 2013),[53] which would lead to a further depreciation of the exchange rate (officially 11% from January to December 2013, but 22.7% when measured against rates at the foreign exchange bureaus)[54] and increase the dollarization of the economy with a further loss of GoG revenue as more economic activity shifts sideway or "goes underground".
5. A negative shock may prevent the Bank of Ghana from building up its foreign exchange reserves[55], exacerbating concerns among investors that the economy is "on" or "over" the edge, leaving it even more exposed.
6. Although the debt projections suggest stability with respect to the rate of growth of total debt and its financing, adverse dynamics could take hold: one possible scenario begins with rising inflation, which leads to a slide in the exchange rate, a subsequent rise in the budgetary cost of servicing the foreign component of Ghana's debt. With interest rates on local currency debt already high, any attempt by the GoG to finance the deficit by expanding credit would give further impetus to inflation, raising the costs of local finance. Such dynamics tripped up a large number of countries, with Turkey, Mexico, and Brazil being prominent examples.[56]
7. Adverse social reactions could prompt the Government to expand "poverty-related" spending. This will add to the deficit. These reactions could readily be triggered by regional resistance to the growing inequality, a need to counter perceptions of rising corruption, increasingly insistent demands by youth who are unable to find "decent work," and the rising costs of "doing business" due to the continued deterioration of urban services (including transport and communications).[57]

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[51] In his "energy briefing" the Minister of Energy (Oteng-Adji, 2012) highlighted the problems at the Jubilee Field, which had *"started experiencing premature production decline from November 2011."* The average daily production declined from 80,000 bbl/day in October 2011 to 63,000 bbl/day by the end of July 2012.

[52] Ghana has a Gas Infrastructure Project which will provide gas products from the Jubilee field primarily for electricity generation. This $700 million venture has already experienced delays (some related to government financing) that forced Ghana to import additional oil (thereby adding to the import bill). They also push back the receipt of revenues from taxation of the gas and related products (Thinkghana, 2013; The Al-Hajj, 2013; Domfeh, 2013).

[53] Ghana Statistical Service, online data base

[54] Bank of Ghana Statistical Bulletin June 2013, Table 25. A significant gap has opened between the BoG rate (held constant for some months at GHc2.09=$1 but currently around GHc$2.22=$1) and the street rate between October-December 2013.

[55] The most recent BoG Monetary Policy Statement referred to the run-off of local foreign exchange deposits.

[56] Reisen (1989) traces these dynamics using a detailed decomposition of the budget identities that highlights the links between the financing of the deficit and local and foreign sources.

[57] Recent data from the World Bank Doing Business Survey (available on the World Bank website) show that in the *Doing Business 2014* data Ghana's position has dropped from 62 to 67. "Paying taxes" and "getting electricity" were the only categories (out of 10) where Ghana registered an improvement over previous years. The World Economic Forum's Global Competitiveness Index for 2013 confirmed these findings. Press reports have Ghana

8. There is absolutely no allowance in the projections for the almost certain budget "blowout" that will likely occur during the 2016 elections, if past experience is any guide. The IMF mentions the need for "resilience to the political cycle" but has nothing built into the projections in case that resilience does not materialize.
9. There are also the "epsilon" factors that could add to the economy's woes. Gold prices could continue to decline, forcing some mines to shut down; cocoa production could fall further as a result of disease/weather; economic instability may emerge in the sub-region with an adverse neighborhood effect; and/or Ghana may begin losing its "star power" as investors begin to realize that a stable democracy (that incurs large budget deficits every four years) offers few business opportunities that can match those in other countries, whether in Africa or elsewhere.

Even if *none* of these adverse factors intervenes to disrupt the economy and Ghana reaches 2018 along the trajectory the IMF has projected, what will have been achieved? The main outcome is that the economy will remain in its current state of dynamic imbalance. This will be an accomplishment, but it will have had five disadvantages:

1. The projected growth will not be inclusive. The wage bill is too high, and the combined increase in debt service and assumed decline in the deficit will squeeze all other recurrent and capital expenditure;
2. No progress will have been made in reducing the degree of informality within the economy;
3. Given that the debt will have risen both absolutely and relatively, the economy will face years (perhaps decades) of continued fiscal consolidation;
4. Significant progress will not have been made in accelerating progress towards the MDGs (or, after 2015, sustained human development). Most of the GoG's resources will have been absorbed paying wages and debt service and recurrent expenditures on operations and maintenance, squeezing and public investment. Moreover, donor assistance (heavily weighted towards the MDGs) will have continued to decline.[58]
5. The persistent macro imbalances will prevent the economy from generating the savings, investment, growth, productivity and employment that will support sustainable human development.

5. The Way Forward, Up, and Out

For Ghana to move forward in ways that promote sustained rapid inclusive growth and accelerate progress towards the MDGs, the government will need both a long term vision and a short term action plan to create and use fiscal space. In crafting both of them, two business principles will prove useful. First, if you don't know where you are headed, any road will take you there. Second, when in a hole, stop digging. The following discussion highlights their relevance.

5.1 Desirable long term parameters and principles

A review of Ghana's economic history over the last three decades suggests that despite literally dozens of plans, strategies, and agendas, there has been no firm guide (or agreement) how and in what direction the country can and should "develop".

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falling 11 places in the World competitiveness rankings (Quandzie, 2013). None of this is encouraging given that Ghana has a long history of low labor productivity (BoG, 2007 esp. pp.28-29; Osei-Boateng and Ampratwum, 2011; McPherson and Vas, 2013).

[58] There is some uncertainty about the number of public sector employees in Ghana. Arhin (2013) uses a number of 1.1 million out of an economically active population of 11.8 million. This appears to be too high. In the 2014 Budget Statement (par. 700), the GoG noted that 478,566 workers (99.7% of the total) had migrated to the Single Spine. On this basis, roughly 4.7% of the labor force in Ghana is employed by the Government.

Ghana's economic and social policy has varied with each short-term development fad. The only common factor has been a far too liberal reliance on money and credit.

That approach has left Ghana with a shallow financial sector, a low savings rate, and an inflation rate that (as shown earlier) is substantially above international norms. The resulting financial instability has continued to undermine the country's prospects for rapid, sustainable, inclusive growth.

During the early 1980s, the government focused on structural adjustment. Some progress was made but largely because of Ghana's renewed access to foreign financing than for the degree of the adjustment achieved. A period in which the emphasis shifted to "adjustment with a human face" provided some marginal relief to Ghana's poorest and most isolated groups. A series of "poverty reduction strategies" (GPRS I & II), which subsequently morphed into a "shared growth agenda" (GSGDA), led to some poverty reduction and some shared growth.

Nonetheless, regional disparities were not addressed and as shown earlier income inequality generally worsened. The HIPC and MDRI debt write-downs and debt forgiveness unleashed an unprecedented round of borrowing, which is still running its course. The IMF support for fiscal consolidation following the difficulties encountered in 2008/2009, did not sustainably reduce the budget deficit or remedy the problem of arrears. Finally, Ghana became an LMIC as a result of a rebasing exercise and the consequent upward revision of GDP of 2010, and not through the conventional process of the complementary integrated growth of income and development of institutional capacities. The result is that many of Ghana's key development indicators remain significantly below those which characterize LMICs (This point is clear from the discussion related to Figure 9 above and in Box 6 below.) Missing from all of these efforts has been a clear view of where the country and society should be headed. More important, the policies that were implemented did not move the economy to a trajectory of rapid, sustainable inclusive growth.

If Ghana is to move beyond its current difficulties, such a path to guide policy will be needed. An appropriate growth path for Ghana is that being followed by LMICs a status which has been widely and enthusiastically embraced by Ghana's leaders. As shown in Box 6, the average performance of LMICs reflects the economic balance that Ghana will need to achieve and the performance gaps it will need to close if it is to grow rapidly, sustainably and inclusively.

Box 5: Ghana as a Lower Middle Income Country

Ghana's leaders and senior policy makers have regularly expressed pride in Ghana's progress from low income to lower middle income status. For example, the 2014 Budget Speech concluded: "The Budget has been prepared with due consideration of the aspirations of the Ghanaian [public] for a better Ghana that provides opportunities for all. It also reflects our determination as a government to deliver on our mandate and our resolve to rise up to the challenge and confront the very difficult responsibility to realign the budget to meet our national priorities. These measures are necessary for making a smooth transition to LMIC status."[59] While no particular LMIC offers an exemplar or template that Ghana might follow in making that "transition," a useful guide for policy makers is the average performance of all lower middle income countries. The following table derived from key data in the *World Development Indicators 2012* underscores some of the changes that Ghana will need to make. (For comparison purposes, and convenience of data availability, we use 2010 as the end-date.)[60]

Indicator	LMIC	Ghana
Av. ann. growth GDP % 2000-10	6.3	5.9

[59] Budget Speech, November 2013, par. 228

[60] With 2010 as the end date, some of the gaps, especially with respect to debt, saving and investment are now larger.

Share of agric in GDP %	17	30
Share of manuf in GDP %	16	6
Total consumption (% GDP)	75	91
Gross capital formation (% GDP)	28	22
Gross domestic saving (% GDP)	28	9
Exports of g&s (% GDP)	29	25
Imports of g&s (% GDP)	28	38
Underweight children (%) 2005-10	24.6	14.3
External debt (% GNI) 2010	24.7	27.2
Aid dependency (% GNI) 2010	0.9	5.5
Spending on R&D (%GDP) 2005-9	0.61	0.23
GDP per unit of energy use[61]	4.6	3.6
Paved roads % 2000-2009	48.6	12.6

These data show that in several key categories, Ghana's performance is well below what LMICs accomplish on average. Overcoming that performance gap (i.e., moving closer to the mean) and in the process shifting the economy to a sustainable (and desired) long term fiscal stance will involve major economic rebalancing. Domestic saving will have to increase (implying that public and private consumption need to decline relative to GDP); the rate of investment will have to rise (primarily to provide the infrastructure required for higher rates of growth); more resources will need to be raised domestically so that gap between absorption and income (reflected in the trade deficit) can close; aid dependence will need to fall; and the structure of the economy will need to change through a revival/expansion of manufacturing.

One challenge for Ghana, and one which determines its future capacity to grow inclusively, is the degree to which the reinforcing cycle of deficits, credit creation, and debt can be broken. Without major progress in this regard, nothing will happen to reduce inflation, ease the pressure on the external accounts, and reduce the accumulation of debt so that macroeconomic instability and uncertainty can diminish. Further, as described in Annex 4, without an end to the prevailing pattern of "fiscal dominance", monetary policy can have no effective role.

When viewed in an international or an historical context, there is nothing unique or "special" about Ghana's current difficulties. The country (driven by public sector demand) is attempting to absorb far more resources than it can mobilize through borrowing, or produce directly at home or indirectly through exports. The government's pro-cyclical budget policy (of running large deficits during periods of growth) accentuates the problem. The persistent inflation and exaggerated depreciation of the cedi are indicators of the degree to which absorption exceeds production/income. One reason why that is happening is that Ghana's policy makers do not sufficiently distinguish between the roles of financial and real capital (see Annex 5). The growth of money and credit does not stimulate growth except under special conditions, none of which exists in Ghana. Ghana's problem is that it has had too much money and credit, rather than too little.

A second reason for Ghana's difficulties is that it is politically risky (even if nationally courageous) to attempt to stabilize and rebalance the economy. The pain of adjustment is invariably short term with the benefits spread out over time.

[61] 2005 PPP $ per kilogram of oil equivalent

These political economy considerations are reinforced by the fact that macroeconomic stability is a "public good" that equally benefits the governing party's supporters and opponents.

In particular, it helps explain why broader issues of instability (which take time to intensify)[62] are generally ignored while the governing party focuses on the short-term allocation of public resources in ways that most directly benefit its supporters.[63] This leads to a preference for policies with narrowly confined benefits that can be more closely directed to particular groups or regions. When carried to extremes, such a "winner-take-all" approach to governing, progressively over-extends the public sector and degrades both the content and quality of economic governance.[64]

When seen in these terms, the first medium to long-term objective is to restructure and reorganize the components of fiscal space – revenue enhancement, increased expenditure efficiency, appropriate debt management, and the effective use of aid.

The second is to markedly improve the quality of macroeconomic governance in Ghana (as described earlier in Box 3). Achieving both will involve a major effort, not presently underway, to re-balance the economy. Rebalancing will require progress along several dimensions.

Over the business cycle, production will need to move into line with absorption, imports with Ghana's capacity to export, the supply of money with the demand for money (at stable prices), government expenditure with government revenue, the budget allocations for operations and maintenance with the public sector wage bill, public sector borrowing with the country's debt servicing capacity, the recurrent/capital division of the budget with the "social overhead capital" needed to support future growth, and domestics savings with investment. Furthermore, the exchange rate will need to be on a trajectory which, given local cost considerations, enhances Ghana's international competitiveness.[65]

Although Ghana's current circumstances suggest that these requirements may be out of reach, they are neither more nor less than the general dynamic balance for which all "high growth economies"[66] strive and seek to maintain over time. More important, they are neither more nor less than how an economy which is being governed in the national interest should be managed.

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[62] This is the time-inconsistency problem which bedevils all policy making, particularly in settings in which the government lacks has no established "reputation" for delivering on its commitments.

[63] This behavioral pattern has been widely discussed in the literature (Bates 1981, p.35; Migdal 1988, Ch. 1).

[64] An excellent review of the dynamics and consequences of "winner-take-all" politics in Ghana can be found in IDEG (2010, Ch. 2). That study identified the main challenge for the political system in Ghana as being to undertake elections and manage transitions in power without undermining macroeconomic stability or jeopardizing development gains. This point is consistent with the discussion in Section 3.

[65] A further element of balance is that the government should match its agenda to its (financial, human, physical, and organizational) capacities. This lesson about "state capacity," widely discussed in the 1997 World Development Report, has been regularly ignored in Ghana. For those wanting evidence, we suggest they read the 231-page Budget Statement (November 2013) cover-to-cover and ask themselves: how much of what is promised or proposed can feasibly be implemented given the GoG's existing (or projected) capacities? Most observers will conclude that this document like many others that various governments in Ghana have produced is an exercise in over-reach.

[66] The World Bank Growth Commission (2008) described the features of these countries in detail. For Ghana to meet its ambitions for sustained, rapid, inclusive growth, policy makers could usefully base their program to re-structure the economy on the lessons provided by these high growth economies.

5.2 Possible short term policies and steps to implement them

The second business principle noted earlier of *"when in a hole, stop digging"* applies directly to Ghana's current circumstances. As explained earlier, the economy is dynamically unstable with signs of deterioration evident in several key indicators. Moreover, as also explained, the 2014 Budget is not a constructive enough response to those circumstances.

An appropriate short-term response by the GoG would have been to fully acknowledge the nature and extent of the economy's imbalances and to re-work the 2014 Budget to jump-start the process of economic stabilization and recovery.

Ghana cannot begin to redress its economic problems—chronic inflation, rapid debt accumulation, exchange rate misalignment, high interest rates, low savings, high consumption, low business confidence, structural balance of payments deficits, sluggish growth, intensifying informality, and an over-extended development agenda – while it continues to run budget deficits (including arrears) that regularly average around 10% of GDP. Moreover, it is the absence of 'credible' programs to bring these deficits under control and address the economy's distortions that continues to induce investor and asset-holder behavior that reinforces the macroeconomic instability.

Properly applied, a cash budget would squeeze inflation and inflationary expectations out of the system in less than a year. A review of the issue, however, suggests that a cash budget would not work in Ghana.

The main reason is that government faces challenges in preventing arrears and, moreover, few people outside the government expect that the government could prevent them. A similar conclusion applies to other potential "rules based" fiscal mechanisms. [67] With a cash budget off the table, other means for breaking the cycle of deficits, credit creation, and debt need to be devised. Four immediate actions appear to be essential. As we noted above, some of these have been suggested in the 2014 Budget.[68] We would urge that they be implemented immediately in ways that achieve the maximum possible immediate effect and supplement the actions we propose:

1. Freeze the public sector wage bill and freeze promotions that do not fill an existing open slot.
2. Freeze all new public investment projects and focus on completing existing projects that are in the pipeline.
3. Release all recurrent resources in the budget for operations and maintenance in full and on time.

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[67] There are now many well-known and widely implemented "fiscal rules." The Maastricht Criteria adopted by the European Union have been widely publicized and when budget and debt pressure began to mount (especially in the wake of the Global Financial Crisis) they were ignored (Lukkezen and Rojas-Romagosa, 2012). Numerous other countries have imposed specific rules on deficits and debt. India, for example, passed the Fiscal Responsibility and Budget Management Act in August 2003 and then subsequently devised ways to undermine its provisions (Buiter and Patel 2010). Recently, Mitchell (2012) in a Ghana-based workshop reviewed a range of potential rules. Each of them is sensible and would have an important impact on fiscal responsibility and budget management, *if* they were implemented. The latter requires fiscal restraint which most governments find difficult particularly as elections approach. Ghana's extended history of budget mis-management provides no indication that a rules-based system would work. In our view, the government's effort would be more efficiently directed towards modest mechanisms of restraint outlined below. Perhaps the most important factor ensuring restraint would be for the press to regularly publish an update and evaluation on the government's performance.

[68] The measures are described in the Budget Statement, 2012, pars. 134-135, pp. 41-42 and relate to improved revenue mobilization, realigning public expenditure priorities, reviewing the financing of capital expenditure items, and completing pipeline, and restructuring the debt to reduce it cost. None of these is exceptional; indeed, they all should be the normal part of any annual budget.

4. Put aside the plan to borrow abroad (Budget Speech par. 92) to restructure the public sector debt.[69]

When combined with the revenue measures in the Budget (the VAT increase and administrative improvements), these actions will have a positive impact on three dimensions of fiscal space – revenue, the efficiency of expenditure, and debt (by reducing the deficit). They will need to be supported by actions to ensure that all available donor resources are used effectively, particularly in areas related to MDG performance. The impact of these actions would be accentuated if in addition to freezing the wage bill, the government took every opportunity to reduce and reconfigure the public sector work force and identify opportunities to enhance service delivery. The Budget Speech noted that selected sub-vented organizations would be moved off the budget. This should be done without further delay.

The goal of these actions should be to cut the 2014 budget deficit (including arrears) to 5% of GDP and 2% of GDP in 2015, and keep it at the latter level. (Achieving this degree of deficit reduction will require holding back allocations of resources to the various funds in the budget. This could be done by having Parliament alter the distribution formula which applies to each fund.)[70] The objective is to ensure that by 2015, the public sector has a neutral impact on credit creation.[71] The deficit will need to be held at or below 2% of GDP (roughly the level of donor inflows) for the foreseeable future if Ghana is to achieve the macroeconomic stability that will enable the economy to have the best chance of growing rapidly, inclusively and sustainably.

This pattern of deficit reduction is designed to forcibly reduce the debt to GDP ratio, sharply cut the growth of money and credit, reduce inflation to low single digits, and create the conditions (expectations, asset-holding behavior, and risk perceptions) that will allow all interest rates to decline. The ensuing financial deepening will provide an incentive for local citizens to increase their savings. The latter will be assisted by the BoG actively accumulating foreign reserves as part of a systematic program to force the exchange rate lower. With the rate of inflation declining and the exchange rate weakening, domestic production will become increasingly competitive. This will provide an incentive for locals to increase capacity and expand employment.

Specifically, it will boost agricultural and rural-based output and stimulate the expansion of local fabrication and manufacturing activities. This will help reduce the growth of imports.

To the degree that the public sector devotes its resources to extending and maintaining the nation's infrastructure, the rising investment and employment will be evident throughout the whole economy. Growth will be increasingly inclusive and progress towards the MDGs and sustainable human development will accelerate. But, none of it can, or will occur unless the GoG is prepared to forego its policy of spending and borrowing beyond the economy's capacity.[72]

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[69] Par. 64 of the Budget Speech indicates that foreign borrowing reduces both the cost and risk of Ghana's debt. None of the perceived gains can, or will, accrue unless the debt stock is capped or, preferably, on a downward trajectory.

[70] Based on our earlier analysis, a preferable policy would be to eliminate the various funds and operate a consolidated budget.

[71] With the growth rate projected to remain above 6% p.a., a 2% deficit will means that fiscal policy will still be loose when judged on a cyclically-adjusted basis.

[72] Interested readers can readily Google examples where rapidly stabilized and reformed by shifting policies which emphasized public and private consumption (which is what Ghana is currently doing) to emphasizing investment, production, and productivity. As noted earlier, the Growth Commission (2008) and Brady and Spence (2010) describe how "high growth economies" (most of which started from unstable circumstances) improved their performance in sustainable ways. Perkins (2013) is an excellent recent description of reform and growth across Asia over the last several decades.

For Ghana to make and maintain the changes that will effectively stabilize the macro economy and foster the conditions for rapid sustainable inclusive growth some major changes in how the government operates will be required. Five short-to-medium run changes will be essential.

1. The program to rebalance the economy and effectively stabilize the macro economy should be managed by the best technical committee that can be assembled.[73] It will need to be overseen by a small bipartisan committee, the members of which are committed to Ghana's economic recovery and not the political fortunes of one sectional interest or another. The local media should be engaged to regularly report on the program's progress or regress.[74]
2. The government needs to substantially cut what it now terms as "priorities." The 2014 Budget (at 231 pages) fails to do that. Currently, the government and public sector in Ghana is attempting to operate well beyond anything that their available capacities (revenue, skills, organization, and physical facilities) can support. Scaling back the public sector agenda will require the government (and whatever party heads up the government) to start beginning to trust that the private sector (especially informal operators) will respond appropriately to improved incentives (lower inflation, a competitive exchange rate, and reduced regulatory obstruction).[75]
3. The government's current support for agriculture is misdirected and modest in the extreme. It is misdirected because the public sector has no capacity to promote agricultural mechanization as outlined in recent agricultural development strategies, the GSGDA, and repeated in the last several budgets. Given the incentives they face, all Ghanaian farmers know far better (and whether) to mechanize their operations. Further, government recurrent and capital expenditure on agriculture (most of which is wages) constitutes less than 0.4% of total government expenditure.[76]
   With agriculture generating more than 25% of the nation's GDP and employing more than 50% of its labor force, questions can easily be raised about the government's priorities in this area.
4. All available government resources (including those freed up from cuts in public sector employment and the wage freeze) should be spent on improving maintenance and operations and, where applicable, completing the pipeline of public sector investment. No one who visits Ghana (whether in the Greater Accra Region, or the other regions, especially in the North) can avoid noticing the massive public underinvestment in roads, electricity systems, health clinics, schools, water systems, and sanitation, and the general state of disrepair of most public facilities throughout the country. Those same visitors will find the accounts of high levels of youth unemployment curiously at odds with the obvious work that could be undertaken providing social services such as trash removal or building social capital by repairing roads, unblocking drains, strengthening erosion control barriers, painting public buildings, and so on.

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[73] Curiously, this was one of the recommendations made by Nordhaus (1975) to help an economy overcome a "political business cycle."

[74] When Bolivia shifted to a cash budget, the government published in the local media revenue and expenditure on a daily basis. In this way, the general public was informed about and could react to both the progress and the slippages. The experience has a lesson for Ghana

[75] From the time of Kwame Nkrumah, successive governments in Ghana have seen their role as taking the "commanding heights" or "leading development." Recent history has shown that approach has often undermined rather than promoted human development. Ghana's lack of attention to sanitation (noted earlier) is an example.

[76] Expenditure on agriculture (without MMDAs) was GHc 87.4 million in 2013 and is budgeted to be GHc 125.9 million in 2014. The latter amount is hardly a rounding error in a budget which proposes spending of GHc 34.96 billion.

5. None of the changes can be implemented without the strictest monitoring and oversight. The persistence of arrears (which are *prima facie* evidence of ineffective budgeting) will undermine any attempt at reform. Numerous mechanisms for controlling arrears have been devised in the past – indeed, it is meant to be a function of GIFMIS.

By pushing these five changes, Ghana's policy makers who are intent on rebalancing and stabilizing the economy can begin to immediately restrain the budget in the ways noted above – freeze the wage bill, freeze new investment, scrap the debt restructuring plan, and fully fund operations and maintenance. As noted above, the goal for 2014 is to reduce the budget deficit to 5% of GDP and in 2015 to 2% of GDP. If implemented, this program would begin to yield results almost immediately. With the Government needing to borrow less money, the debt stock would begin to contract and interest rates on Treasury Bills and Bonds would begin to fall. With less public sector demand, fueled by money creation, local prices would cease rising as rapidly as at present, and the rate of inflation would decline. With fewer real resources being provided to public sector workers in the form of wages, the growth of imports would begin to moderate. The latter trend would be assisted by the depreciation of the cedi (as the BoG builds up reserves) and exporters begin earning more (in cedis) for what they sell abroad.

All of these trends need to be monitored closely and additional short-term measures taken as necessary to further reduce the budget deficit. The government's goal should be to have a "mid-year review of the budget statement and economic policy" which, in contrast to the reviews over the last decade, cuts government expenditure and further reduces the deficit.[77]

None of these efforts will be sustained without close attention by the government to the skills and capacities required of all public sector employees to fully undertake their assigned tasks. To support its rebalancing and stabilization program, the government should engage with the country's development partners to ramp up capacity development. In many cases, this will involve expanding existing programs. The immediate short-term goal should be to ensure that as many public sector workers have the skills and knowledge to undertake the tasks that directly contribute to Ghana's rebalancing and macro stabilization. Over time, the programs can be expanded in ways that deepen the skills of all public sector workers. Since the challenges of managing the Ghanaian economy will change but not diminish, this effort should be seen as a permanent.

6. Concluding Remarks and Recommendations

At present, Ghana has practically no fiscal space to promote inclusive growth and accelerate the achievement of the MDGs. Under current circumstances, Ghana has no means of making room in the budget to support social objectives in ways that do not further jeopardize the Government's financial position or the stability of the economy (see Box 1). The current budget is massively over-extended, with wages and debt service absorbing close to 70% of total expenditure and almost 95% of non-earmarked tax revenue. The implication is that most of the functions of government and public sector investment are being supported through the expansion of debt to cover the gap beyond earmarked allocations, self-generated funds and contributions from development partners. Given that the debt ratio is already (or close to) being unsustainable and the international agencies have downgraded the country's debt twice in the last 6 months, adding to the debt would be imprudent. The 2014 Budget provided an opportunity to address the country's difficulties but, with its present structure, that will not happen.

[77] For example the 2011 "mid-term review" revised revenue up by 12.6%, expenditure (from a larger base) increased by 11.2% and the budget deficit by 27.7%. The budget documents in 2012 revealed that even these adjustments were inadequate and were over-shot by substantial margins.

The projected deficit of 8.5% of GDP for 2014 will compound Ghana's economic problems by adding to the national debt, boosting inflation, accelerating the rate of currency depreciation, and undermining the (already dwindling) private sector confidence needed to support investment and expand the economy's productive capacity.

The Government has policies to increase revenue and has suggested actions (such as focusing on projects in the pipeline) to improve the efficiency of expenditure. But the Government has no plans to reduce the national debt (indeed, the Budget program adds to the debt), and it has no feasible program for improving the efficiency of donor support. Indeed, the massive recurrent cost problem (in which only 1% of GDP is being spent on operations and maintenance versus 10% plus of GDP on personal emoluments)[78] implies that all aspects of the Government's operations are over-staffed relative to the resources and facilities which would enable public sector workers to operate efficiently. There appear to be no policies and actions in place which can credibly stabilize the Ghanaian economy so that the macroeconomic context which supports the expansion of fiscal space can improve.

This paper proposes a two-phase program to deal with these difficulties. The first is a set of actions (freeze the wage bill, freeze new investments while the pipeline of projects is cleared, put aside plans to refinance the national debt by borrowing abroad, and fully fund all operations and maintenance) which are designed to forcibly reduce the budget deficit (including arrears) to no more than 5% of GDP in 2014 and 2% in 2015 and beyond. This action will remove the public sector as a net source of credit creation and move the national debt ratio onto a downward trajectory. These short-term measures will form the foundation for the second longer-term phase to rebalance and stabilize the economy. That rebalancing will only be accomplished when *over the business cycle* national absorption is brought into line with domestic output/income, expenditure with revenue, savings with investment, the supply of money with the demand for money (at stable prices), imports with export capacity, borrowing with debt servicing capacity, the development agenda with the public sector's implementation capacity, and the exchange rate is at a level which ensures Ghana is internationally competitive. Given Ghana's current difficulties, none of the above will be easy. It will require technical expertise and political cooperation that heretofore has never been mustered in the service of Ghana's national development. Yet, it will be far less challenging than the difficulties that are almost certain to emerge if the government continues its current business-as-usual approach. The strategy outlined in the 2014 Budget does not go far enough, nor does it act quickly enough. The debt downgrades by the international rating agencies have made this perfectly clear. The reality is that Ghana cannot borrow and spend its way out of its present predicament.

The basic issue going forward is whether the Ghana's leadership (government and opposition) can collectively rise above the presumption that business-as-usual will suffice.

If they do, the country can begin to repair some of the economic damage that has occurred over recent decades (chronic inflation, unsustainable debt, rising inequality, widening regional disparities, growing informality, slow overall human development, and uneven progress towards the MDGs). By repairing and rebalancing the economy, Ghana can generate the fiscal space within a stable macroeconomic setting which will support higher rates of human development and MDG achievement. This will enable the country to take its place among progressive lower middle income countries which are role models for both political *and* macroeconomic governance.

[78] Budget Speech, November 2013, par. 74

In light of this, our 10 recommendations are:

1. Constitute a technical team, supported by a bipartisan oversight committee, with the responsibility to immediately begin the process of preventing any further damage to the economy (through deficits and debt) and to take the measures required to set the country on a longer-term program of rebalancing and stabilization.

2. Rework the 2014 Budget to impose a maximum limit of 5% on the budget deficit (including arrears) by freezing the wage bill, freezing all new investment projects while the pipeline of existing projects is worked off, scrapping the plan to refinance the debt from abroad, and fully funding all operations and maintenance expenditure.

3. Implement long-standing commitments to remove from the national budget all items and activities (including subvented agencies) and redundant activities. Official travel and representation abroad would be a useful place to introduce economies. The progress achieved should be published monthly in the local media. This will be an excellent opportunity to take full advantage of the GoG's commitment to the establishment of the fiscal transparency portal and implementation of the open budget initiative.

4. To reduce the rigidities within the budget, work with the Parliament to begin dismantling the various funds. At a minimum rework the revenue allocation formula to reduce the drag of all of these funds on the budget.

5. Prepare an indicative budget for 2015 with a maximum limit (including arrears) of 2% of GDP on the budget deficit.

6. Begin removing the regulations which continue to restrict the trading, investing, business formation, and entrepreneurial activities of the private sector, especially for those who, thus far, remain trapped in informal activities. The rules related to public sector employment could be constructively reformed in the process.

7. To protect the economy against shocks, ensure that the Bank of Ghana with all due deliberation accumulates and maintains a foreign reserve equivalent to a minimum of four months of import coverage.

8. Re-engage with the development partners to ensure that all available funds are released so as to support MDG achievement and promote human development. This would improve the efficiency of both government and donors programs while simultaneously enhancing aid effectiveness.

9. To the extent possible redirect all public sector capacity improvement programs to develop the immediate skills so that the skills and productivity of all public sector workers can increase. The Development Partners should be brought on board to support these activities.

10. Elicit the local media and Parliament to fully inform the Ghanaian public of all of the above actions, their progress and regress.

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Annexes

Annex 1: Conceptualizing and Using the Fiscal Space diamond

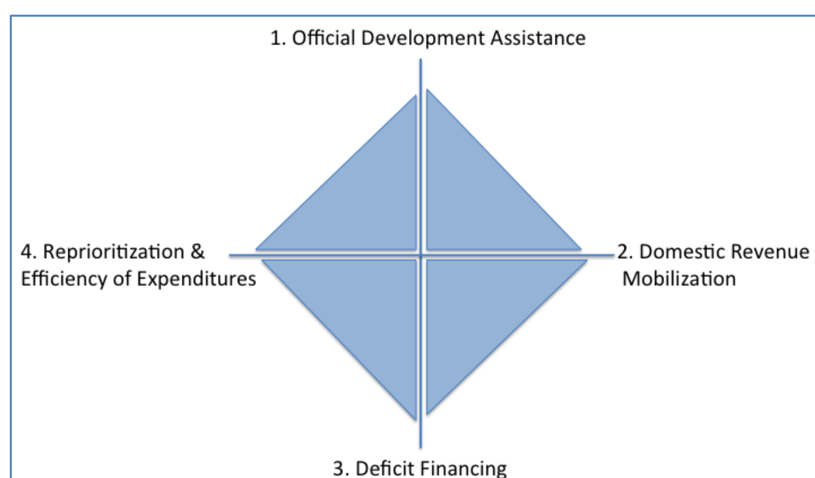
Following previous studies,[79] the main sources and determinants of fiscal space can be usefully discussed using a fiscal space 'diamond.' It has four dimensions, each of which is expressed in terms of a comparator, typically as a % of GDP.

1) Official Development Assistance (ODA) through aid and debt relief

2) Domestic revenue mobilization through tax administration or tax policy reforms

3) Deficit financing through domestic and external borrowing

4) Reprioritization of activities and raising the efficiency government expenditure



The diamond serves as a visual map and a diagnostic tool enabling governments to better raise and allocate resources to meet their social and other objectives. Although the diamond can be approached in absolute or incremental terms—keeping the comparator constant in both cases—it is most useful in assessing the implications of *increasing* (by some percentage points of GDP) the resources allocated to a defined set of goals. The diamond helps keep in perspective the dynamic interaction among all four sources that contribute to fiscal space.

Within a given context, many parameters will determine the desirable and feasible mix of financing options. Each will depend on the nature and scope of the government's policy objectives and the degree to which one or more sources of finance are available and/or will be responsive to changes in domestic policies.

A number of lessons from economic theory and history are useful as well. For example, deficit financing should be limited, whenever possible, to socially productive investment. Movements along the vertical axis will tend to pre-occupy less developed countries when the main objective of fiscal policy is to spur growth and expand access to basic social services. Movements along the horizontal axis will be more relevant to richer countries where the stabilization, allocation and redistribution functions of public finance predominate.[80]

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[79]Heller, 2005, Development Committee, 2006, Roy *et. al*, 2006, 2007, UNDP/GoG 2011

[80] Musgrave and Musgrave, 1989

Annex 2: Has Ghana's Recent Growth Been "Broadly Inclusive"?

In its recent Country Report, the International Monetary Fund (IMF 2013, Appendix II, p. 36) noted: "Ghana has experienced strong and broadly inclusive growth over the last 20 years, defined as growth that raises the income of most or all in society, including the poorest groups." This statement is valid only in the most general sense and only if the notions of "broadly inclusive" and "most or all" are loosely interpreted. Indeed, by several well-known measures, Ghana's growth trajectory has been far from inclusive.

Data in the text show that the Human Development Index increased from .427 in 1990, to .461 in 2000, and .558 in 2012. These changes are impressive until the components of the HDI (life expectancy, literacy/knowledge, and income) are adjusted for inequality. UNDP recently began reporting an inequality-adjusted HDI. For Ghana, in 2012, it was .386 or 44.5% below the unadjusted HDI. This gap is among the largest for any country in the world.[81] Data from the *World Development Indicators* show that inequality in Ghana has been increasing over time. Data from 1997, 2003, 2012, covering the IMF's "last 20 years", show that income/consumption inequality in Ghana has increased markedly.[82] The Gini coefficient for 1992 was .339, in 1999 it was .396 while in 2006 it was .428. Over that period, the P(90)/P(10) ratio increased from 8.0 (1992) to 16.4 (2006).[83]

Further evidence of the lack of inclusiveness has been the sharp drop in agricultural income in GDP relative to a much slower decline in the agricultural/rural population. Between 2008 and 2012, the share of agricultural labor/rural population in the total labor force/population fell from .50 to .48 whereas the share of agricultural GDP declined from .31 to .23.[84] With the population share declining by 4% and income share falling by 26%, the rural-urban income (and welfare) gap widened sharply.

Disparities in progress towards the MDGs by region, gender and age groups re-confirm the lack of inclusiveness. These rural-urban and regional disparities have been well documented in the recent GoG/Ghana Statistical Service Multiple Indicator Cluster Survey and the Ghana Statistical Service report on the MDGs.[85]

Three data illustrate the point. (Other data reinforce rather than weaken the argument.) Under-5 mortality in rural areas was 94 per 1000 live births in 2011; it was 72 in urban areas. It was 106 in the lowest wealth quintile and 52 in the highest. Among the rural population (0-5 years) 26% (16%) were stunted (underweight); for the urban areas the corresponding data were 18% (11%). Based on wealth quintiles, the data for the lowest were 33% and 20% respectively while for the highest quintile the corresponding data were 12% and 7%. Finally, with respect to the use of improved sanitation, coverage was 21% in urban areas and 9% in rural areas while the lowest quintile it was 5% and the highest it was 38%. As a further reflection of the lack of inclusiveness, the rates at which these measures improved have been less in "rural" regions, particularly in the North. This is clearly illustrated in the regional poverty data reported in the text.

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[81] Data from http://countryeconomy.com/hdi/ghana and www.hdrstats.undp.org/en/indicators.

[82] WDI 1997, Table 2.6; 2003, Table 2.8; 2012, Table 2.9.

[83] P(10) is the income/consumption share of the lowest 10% of the population; P(90) is the corresponding share for the highest 10%. The implication of these data is that if the inequality-adjusted HDI had been available it would have shown a growing gap between the HDI and iHDI over time. That is, growth and opportunity would have become less inclusive (or broad-based) over time.

[84] World Bank MetaDataSeries_Ghana at www.worldbank.org

[85] GoG *et al.*,2012; GSS, 2013

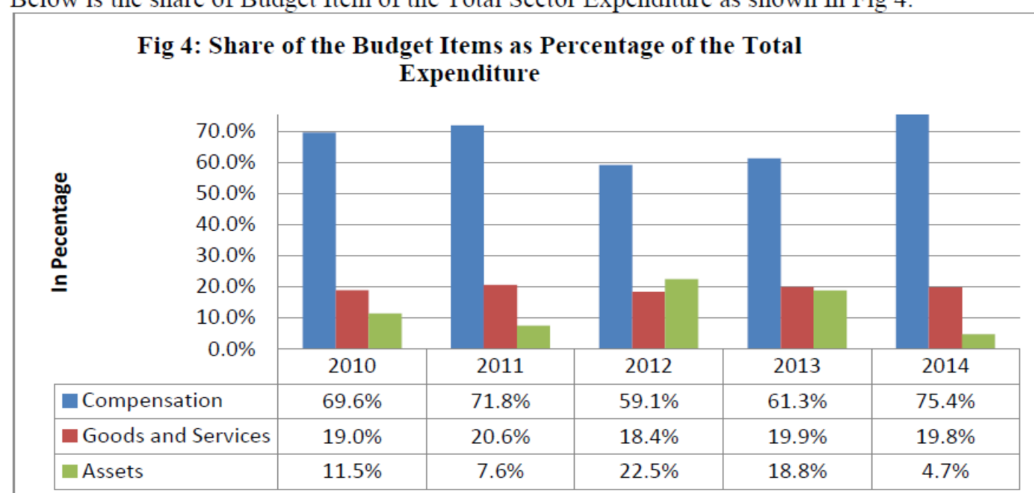
Annex 3: Expenditure Allocation and the MDGs

A detailed analysis of the allocation of expenditure is not essential to the main macro messages in this study. Nonetheless, a brief overview of the pattern of fiscal allocations to key social sectors and MDG is useful to highlight the gaps in MDG performance noted in the text. Data on education appear in the following table.

Education

Trend Analysis of the share of Budget Item as a Percentage of Overall Sector Expenditure

Below is the share of Budget Item of the Total Sector Expenditure as shown In Fig 4.



	2010	2011	2012	2013	2014
Compensation	69.6%	71.8%	59.1%	61.3%	75.4%
Goods and Services	19.0%	20.6%	18.4%	19.9%	19.8%
Assets	11.5%	7.6%	22.5%	18.8%	4.7%

Source: Computed from Budget Documents 2010 to 2014

These data which have been kindly provided by UNICEF in Accra reinforce the point (noted in the text) about the major imbalances that exist across expenditure components.[86] None of the MDG data illustrate differences in quality of service delivery or performance across regions. The above data, however, point to a major quality problem. With such a large persistent discrepancy in resources devoted to personnel versus operations and maintenance ("goods and services") and "asset," quality of education services must necessarily decline. Teachers without books and stationery, and schools without facilities (especially sanitation and water), do not provide a conducive learning environment.

Health

Within the Health sector, the allocation for 2014 is programmed to be GHc 3.3 billion. In nominal terms this is around 5% less than the GHc 3.5 billion provided in 2013. When inflation is factored in, the decline represents are real cut of more than 15%. This decline continues the downward trend in the share of health expenditure in the total Ministries, Departments and Agencies (MDAs) budgeted expenditure. That share was 22.5% in 2011.

[86] The discrepancy in GoG funding is even more dramatic than the bar charts show. The development partners have provided a large part of the operations and maintenance support and assistance for "assets". This point is reinforced by evidence from the 2014 Budget which shows that GoG support to the education sector is GHc 4.6 billion, GHc 4.4 billion (or roughly 96%) is for salaries and wages. (These data were compiled by UNICEF.)

In 2014, it is 19.8%. When viewed against the background of the high rates of maternal and under-5 mortality in Ghana (two dimensions of the MDGs in which Ghana is seriously short of its targets),[87] these cuts do not represent an adequate response.

Sanitation

The 2014 Budget has set as a target the improvement of (safe, potable) water supply coverage from 63.4% to 70% of the population. To achieve this, the Ministry of Water Resources, Works and Housing (MWRWH) will have to massively increase its efficiency. Relative to 2013, its budgeted resources has been reduced by 11 percent in nominal terms. When adjusted for inflation, the cut approaches 22%, a trend which is contrary to the needs of a sector which is already highly aid dependent. With the development partners scaling back their assistance, the GoG should be increasing expenditure allocations in areas for which it needs to assume greater responsibility.

A further anomaly in the 2014 Budget allocation for sanitation is that the rural sector's budgeted allocation has been severely cut. The current allocation will not sustain existing deliveries. For that to be rectified the share of the sanitation but should at least be maintained at the 35.2% level of 2010.

While the budget allocations above will undermine progress towards the MDGs in the areas of education, health and sanitation, some progress has been made in the area of gender and social protection. The Budgeted Expenditure for the Ministry of Gender, Children and Social Protection has been raised substantially from its (low) 2013 level of GHc 38.6 million. The overall budget now stands at close to GHc 100 million. Proposed expenditures on all items, personnel, goods and services and assets have been increased. The challenge for the Ministry will be to use these resources efficiently.

As welcome as these changes appear, some perspective is needed: the total MoGCSP budget is only half the amount cut from the health budget.

Annex 4: Finance, investment, and real productive capacity[88]

Too many developing country governments have presumed (or behave as if they presume) that finance capital (money and credit) can create real capital (i.e., the productive facilities, information, and organizations which underpin sustained economic growth). This is an error that leads to macroeconomic instability and decline rather than growth. Gerald Meier underscored the point:[89]

"Although the existence of a more developed capital market and financial intermediaries will aid in the collection and distribution of investible resources, they in no way lessen the need for real saving. The rate of investment which it is physically possible to carry out is limited by saving, and a "shortage of capital" – in the sense of a shortage of real resources available for investment purposes – cannot be solved merely by increasing the supply of finance." This same error can be found to be operative in Ghana. Data from 1980 to 2011 (and any sub-period in between, including the last decade) confirm this. Using the World Bank's MetaDataBase,[90] the following total changes can be derived:

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[87] GoG/UNDP, 2012

[88] Duesenberry and McPherson, 1991, pp. 25-26

[89] Meier, 1989, p. 186

[90] MetaDataBase_Ghana at www.worldbank.org

Change 1980-2011[91]

Growth of real GDP (%)	*283*
Growth of labor force (%)	*129*
Average savings rate (% GDP)	*5.9*[92]
Average investment rate (% GDP)	*17.*
Growth of nominal money supply (%)	*2,299,000*
Growth of net domestic credit (%)	*1,701,000*
Increase in price level CPI (%)	*179,900*
Increase in price level GDP deflator (%)	*361,400*
Depreciation of the nominal exchange rate (%)	*99.98*

Even with this (crude) degree of aggregation, the top and bottom data panels bear no relation to one another. The expansion of the productive capacity of the economy – determined by the growth of the labor force, the availability of real savings, and increase in real investment – is disconnected from the trajectories of money, credit, prices and the exchange rate. Over the same period (i.e., 1980 to 2011), the economy grew by 4.4% per annum or slightly above the growth rate of the labor force (and population) of roughly 2.6%. Based on this growth rate and the average investment rate, the (incremental) capital-output ratio was slightly below 4. The gap in average domestic savings and investment was "covered" by foreign aid, foreign direct investment, borrowing, and until Ghana's foreign debts were rationalized under HIPC and MDRI programs, the accumulation of arrears. None of these trends shows any *positive* tangible connection to the 2.2 million percent increase in money supply and the 1.7 million percent increase in net domestic credit. If (as has been so widely believed) finance could stimulate real growth and development, Ghana would now be among the richest countries on the planet.

The above points do *not* imply that finance has no role in boosting real output. The required conditions are exacting: finance will only increase real capital and support economic expansion if it mobilizes real savings (i.e., resources set aside from current consumption) that are then productively invested. These conditions have not been operative in Ghana over the last three decades. Indeed, the hyper-expansion of money and credit had exacerbated macroeconomic instability (evident in the exaggerated rate of price inflation and depreciation of the exchange rate) which undermined the economy's capacity for growth. The instability led to increased uncertainty, kept savings low, and deterred investment. The limited expansion of productive capital assured that labor productivity would remain low.[93]

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[91] Only some of the data are available for 2012. Adding this last year does not change any of the conclusions.

[92] The savings (investment) rate was 4.9 (5.6)% in 1980 and 5.8 (18.9)% in 2011. The corresponding average gap between imports and exports over the entire period was 11.2% of GDP.

[93] Evidence provided by McPherson and Vas (2013) derived from the World Bank MetaDataBase shows no increase in labor productivity in agriculture over the last three decades. The increase in the non-agricultural sector was approximately 1.4% per annum.

Annex 5: The Irrelevance of Current Monetary Policy in Ghana

The IMF Country Report (June 2013, p.16) noted: "There was broad agreement that monetary policy needs to remain tight until fiscal consolidation is firmly established." At best, this misrepresents the point; at worst, it misses it. Monetary policy has no room for independent action in Ghana, something the IMF confirmed when it noted: "The sharp increase in net credit to government far exceeded the statutory limit of 10 percent of revenue for total bank financing and risked weakening the perception of the BoG's independence, as well as the credibility of the inflation targeting regime."[94] Fiscal excess – evident in large budget deficits and increasing debt – precludes any possibility of an independent monetary policy by the Bank of Ghana. That is, the BoG's principal instrument (the Policy Rate) is irrelevant in managing the economy.

As explained on the BoG website, the BoG's Monetary Policy Framework targets inflation:

"The Bank's monetary policy objective is to ensure price stability – low inflation – and, subject to that, to support the Government's economic objectives including those for growth and employment. Price stability is defined by the Government's inflation target….The Bank seeks to achieve government's inflation target by setting an interest rate."

There are two problems with the BoG's goal of keeping inflation at, or around, the rate set by the Government. First, none of the conditions relevant to applying an inflation targeting framework (ITF) hold in Ghana. Second, the chain of causation does not run from interest rates to inflation (as the BoG presumes), but the other way round. The literature has been explicit on what is needed for inflation targeting to succeed. An IMF study noted:

"Inflation targeting requires two things. The first is a central bank able to conduct monetary policy with some degree of independence….. To comply with this requirement, a country cannot exhibit symptoms of "fiscal dominance" – that is, fiscal policy considerations cannot dictate monetary policy. …The second requirement for inflation targeting to work is the willingness and ability of the monetary authorities not to target other indicators, such as wages, the level of employment, or the exchange rate."[95]

Despite gaining (instrument) "independence" under the Bank of Ghana Act 2002, the BoG has always been subject to "fiscal dominance." There have been persistently large budget deficits (1980 to 1985 and from 1996 onwards) funded primarily through the expansion of money and credit. The outcome has been high sustained rates of CPI inflation. It averaged 30.1% p.a. from 1980 to 2011 and 14.6% p.a. from 2002 to 2011. The decline in inflation over the last decade owes more to the general reduction in international inflation ("the Great Moderation") than to any "policy rate" manipulation by the BoG.[96]

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[94] IMF June 2013, p. 16. The IMF concluded that government actions which force the BoG to break the law (by breaching the 10 percent funding limit) "weakens the perception of the BoG's independence." This misses the point:--the BoG's inability to deny the GoG funding is explicit evidence of its lack of independence.

[95] Debelle *et al.*,1998, p.1. The criteria provided by Faust and Henderson (2004, p.117) were simpler: "The core requirements of inflation targeting are an explicit long-run inflation goal and a strong commitment to transparency." Ghana's inflation target is "single digit" which, in practice, provides considerable wriggle room. The persistent accumulation of arrears is evidence that transparency has not been a high priority.

[96] To illustrate, the rate of inflation in the United States was 5% during the 1980s, 3% in the 1990s; it has averaged 2.3% p.a. since 2000. The rate of inflation in Ghana has declined by a little more than a half since the 1980s and 1990s as well. It was 48.3% p.a. in the 1980s, 27.6% in the 1990s, and 18.5% p.a. in the 2000s. Data from the International Financial Statistics show that Ghana's annual Discount Rate prior to 2002 averaged 19.1% in the 1980s and 35% in the 1990s. It was 27% until around January 2004 and (redefined as the Monetary Policy Rate) declined in steps to 12.25% in January 2007, rose to 18.25% in May 2009 and declined to 12.25% in May 2011. It

The second point follows from the exceedingly high monetary velocities in Ghana over the last three decades. The annual average growth of broad money (M2) over the period 1980 to 2011 was 38.6%. Since the BoG became "independent," the average has been 31.5%. The monetary base and domestic credit, stimulated by deficit financing, grew at similarly elevated rates. While this pattern of hyper-expansion persists, neither the Bank of Ghana nor the GoG can begin to establish any credibility (or "reputation") for effectively or efficiently managing Ghana's monetary or fiscal systems, or debt. More important, under these conditions, none of the "normal" policy frameworks such as Inflation Targeting, the Taylor Rule, or others, can apply. Indeed, the direction of causality is exactly the opposite of how the BoG's description. It is not high interest rates (anchored by a "Policy Rate") which will reduce inflation; it is the decline in the rate of increase of key monetary aggregates (base money, broad money, bank credit) that will lower the rate of inflation. (Students of monetary theory will recall Milton Friedman's assertion that high interest rates do not reflect tight monetary policy; rather they are the result of monetary policy which has been too loose.) More important, it is only when asset-holders begin to believe that inflation will remain low, that the exchange rate will stabilize and lenders will begin to accept lower rates of interest.[97]

As demonstrated in dozens of other countries which have experienced extended periods of high money and credit growth, the rate of increase of monetary aggregates will only begin to decline on a sustainable basis when the budget deficit is reduced and/or eliminated. As explained in Box 7, several countries – Bolivia, Dominican Republic, and Zambia – broke the link between rapid monetary growth and inflation by shifting the government to a cash budget. It is only when the economy stabilizes – i.e., inflation drops sharply, the rate of depreciation of the exchange rate eases, and the stock of Government debt declines – that the central bank can begin thinking about using interest rates to hold prices in check. Until that time, the BoG will be effectively 'hostage' to the GoG's "fiscal dominance" and "independent" monetary policy in any meaningful sense will be out of reach.

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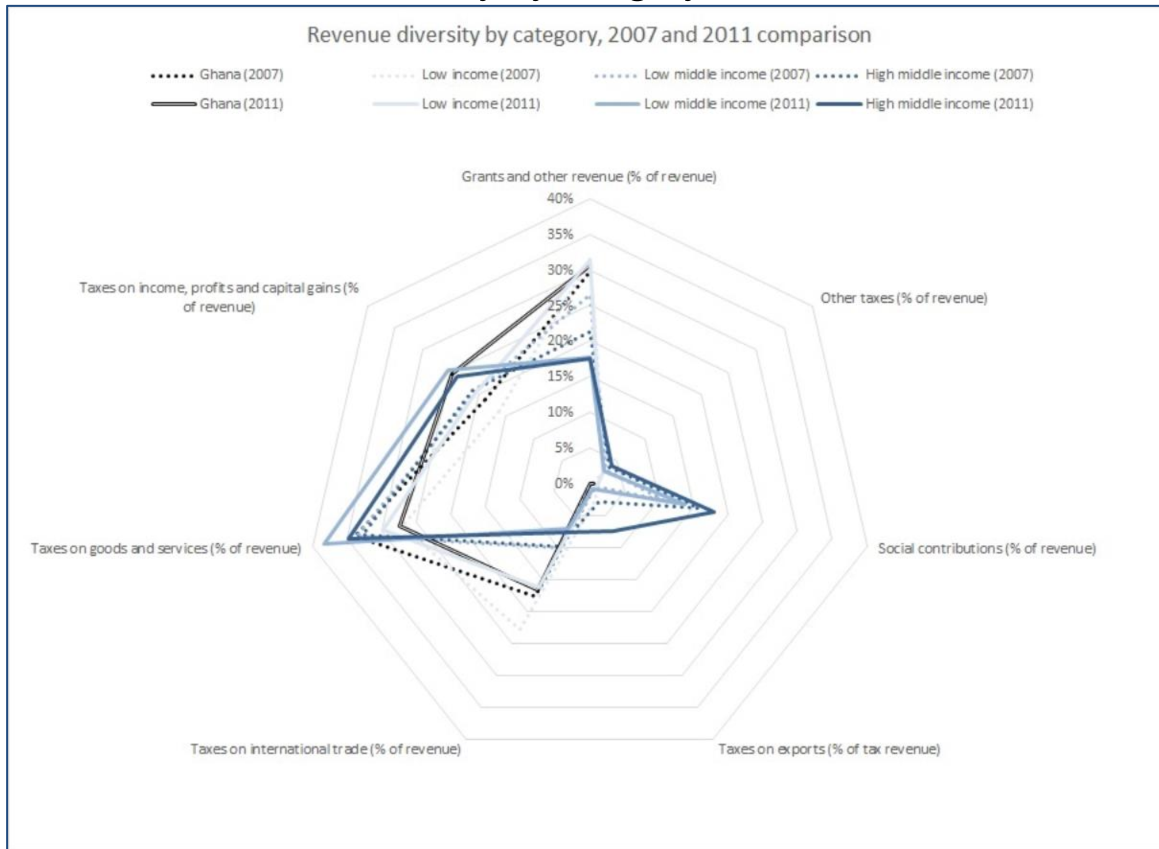
was raised to 15% in July 2012 and to 16% in May 2013. The Policy Rate averaged 16.5% for the period 2002 to 2012. (The most recent data come from the IMF e-library, IFS online November 2013, p.342.)

[97] The Treasury Bill rate averaged 16.1% p.a. during the 1980s; 35% in the 1990s; and 22.1% during the 2000s. In September, it was 20.8% p.a. (Data are from IFS online and BoG website.)

Annex 6: : Revenue diversity by category, 2007-11



Annex 7: Photos of field trip to the North (December 2013)

Photos taken by Malcolm McPherson [separate file for the purposes of this draft to keep the file size low]

Country road and town

Water works, last used in 2002

Cassava processing plant