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

[1] Study conducted under the auspices of the Government of Ghana and United Nations Development Programme in Ghana

Acknowledgement

This report could not have been completed without the invaluable contributions of a number of individuals and organizations. We are especially grateful to our consultants, Emmanuel Letouzé, Malcolm McPherson, and Robert D. Osei who are affiliated with University of California Berkeley, Harvard University, and University of Ghana, Legon, respectively. Particular appreciation is also due to the various agencies (Government & Development Partners), which shared their experience, reports and data with the team. We are especially grateful for the incisive comments and criticisms provided by officials, DPs and members of the press at the validation session on February 15th, 2011.

The views and comments are those of the authors and do not necessarily reflect those of UNDP and the Government of the Republic of Ghana.

Table of Contents

List of Tables

List of Figures

Acronyms and Abbreviations

ADMD	Aid and Debt Management Division
CG	Consultative Group
DACF	District Assembly Common Fund
DP	Donor Partners
GDP	Gross Domestic Product
GIFMIS	Ghana Integrated Financial Management Information System
GoG	Government of Ghana
GSGDA	Ghana Shared Growth and Development Agenda
HIPC	Highly Indebted Poor Country
HIV/AIDS	Human Immuno-deficiency Virus/Acquired Immune Deficiency Syndrome
IMF	International Monetary Fund
LIC	Low Income Countr
LMIC	Lower Middle Income Country
MAF	MDG Accelerated Framework
MDBS	Multi-Donor Budgetary Support
MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MIC	Middle Income Countries
MoFEP	Ministry of Finance and Economic Planning
NDPC	National Development Planning Commission
NHIS	National Health Insurance Scheme
ODA	Official Development Assistance
SOEs	State Owned Enterprises
SSA	Sub-Saharan Africa
UNCT	United Nations Country Team
UNDP	United Nations Development Programme
WDI	World Development Indicators

Executive Summary

1. This study reviews the potential for expanding fiscal space to support human development objectives along its four main 'pillars': Domestic revenue, Official Development Aid (ODA), borrowing, and increased efficiency and reallocation, in light of Ghana's recent socio-economic performance and the challenges ahead.

2. Ghana has made noteworthy progress in promoting development and in progressing towards the Millennium Development Goals (MDGs). With the target date of 2015 looming, there is concern that some of the recent progress may not be sustained. The deterioration of the fiscal and debt situations have deteriorated as a result of internal budgetary slippages, pressure for large increases in recurrent expenditures (some of which are related to the MDG targets), and external developments, especially the spillover effects of the international financial collapse.

3. The key conclusion of our analysis of prevailing constraints, opportunities, and uncertainties—including the implications of the exploitation of oil and of the recent 'rebasing' of GDP—is that the principal means for creating additional fiscal space to boost progress towards the MDGs by the 2015 benchmark will come from increased efficiency and reallocation of expenditures within the Ghanaian budget.

4. In view of its history of persistent deficits, low savings rate, Ghana lacks the policy credibility to support a large-scale deficit-financed investment strategy and counter-cyclical fiscal expansion. There is also little prospect of additional support from development partners in the foreseeable future. As it becomes (or has already become) a Middle-Income Country (MIC), Ghana's access to concessional lending and grants will decline. Ghana would benefit by reducing its debt to improve its credit rating and by devising a clear exit strategy from aid.

5. Neither the prospect of oil revenues nor the conclusions of the recent rebasing exercise will fundamentally transform Ghana's development prospects. Notwithstanding popular perceptions of an "oil boom," there is little to indicate from present estimates that future oil revenue will resolve Ghana's macro fiscal imbalances and structural weaknesses and be in itself 'developmentally transformative'. The result of the recent 'rebasing' exercise—revising Ghana's GDP upward by 75 percent—substantially reduces the relative impact of future oil revenues. The new GDP estimates do not dispel concerns about structural imbalances either. Rebasing changes some of the key indicators; it does not necessarily change any of the structural features of the economy upon which present and future economic growth depend.

6. The rebasing exercise, however, sheds new light on a number of parameters and options. It suggests that the country's actual tax effort is below 15% rather than around 25% as currently estimated, pointing to the potential for raising tax effort over the medium run. Similarly, the newly computed GDP estimates are likely to foster a rating upgrade and expand Ghana's access to external finance on commercial terms in the medium run. At the same time, these estimates also reduce Ghana's current net savings rate, reinforcing the conclusion that further deficit financing would be imprudent in the short and medium terms.

7. This study argues that the principal means for creating additional fiscal space to boost progress towards the MDGs by 2015 will come from adjustments within the Ghanaian budget. Key elements will be the reallocation of expenditure, more effective revenue generation, improvements in efficiency of public sector operations, and cuts in some of the least productive activities.

8. The Government can also create additional fiscal space by measures that improve macroeconomic management so as to raise the rate of economic growth. Specific actions related to deficit reduction, bringing the national debt back into conformity with long-term sustainability criteria, maintaining a competitive exchange rate, and reducing the regulatory burden will also help re-balance the economy and stimulate private sector activity, particularly among small-scale operators.

9. None of these adjustments will be easy and few of them are what the Government or the general public expects. With their country having discovered oil, the majority of Ghanaians expect to enjoy a brighter and more prosperous future. That future may come but current projections show that oil revenues will not be adequate to the task. A brighter and more prosperous future awaits in human development terms for all Ghanaians if they make the changes that will improve public sector delivery and their elected officials take the decisions needed to re-balance the economy in ways that boost the rate of economic growth and use efficiently the additional resources generated by growth.

Introduction

Achieving the targets set for the Millennium Development Goals (MDGs) has been a centerpiece of the Government of Ghana's (GoG) commitment to human development and economic growth. The targets were included in the Ghana Policy Reduction Strategy I (2003-2005) and II (2006-2009) and were recently re-affirmed in the Ghana Shared Growth and Development Agenda I (GSGDA I) (2010-2013). Much of the assistance provided by Ghana's principal development partners (DPs), including the United Nations Development Programme (UNDP), has been designed to create the conditions that enable the country to achieve the MDGs. Due to an extended period of strong economic performance, with GDP growth averaging about 5.2 percent per year since 2000 (WDI, 2010), Ghana is on track to meet the most of its MDG targets. The exceptions relate to child health, maternal health and the sanitation dimension of MDG 7. For this reason, Ghana is often presented as a 'success story' among the development community and in the media. But much needs to be done and uncertainties remain.

Indeed, Ghana will not meet all of the MDGs by 2015 without renewed and additional efforts from all stakeholders even if current positive trends continue. Moreover, while specific MDG targets will be met, there is always room for further improvement. This is illustrated by the need to boost the quality of teaching and learning in primary education. Ghana also faces a number of macroeconomic challenges that may jeopardize its continuing progress towards the MDGs and the promotion of human development.[2]

The deterioration in Ghana's macro-fiscal stance since 2008 due to internal budget-related slippages and the adverse knock-on effects of the global financial crisis preceded by fuel and food price hikes of 2007 have been widely analyzed. To its credit, the GoG has already steps and has more in process to address the most pressing consequences with the support of the IMF and other DPs. There is widespread concern that the measures chosen will substantially diminish the resources available to support and sustain progress towards the MDGs. These adverse developments result from the persistence of structural weaknesses.

[2] For simplicity we use 'human development' and 'the MDGs' interchangeably within the 2010-2015 timeframe and 'human development' past 2015. We recognize that human development is broader than the MDGs.

Moreover, because of these weaknesses, the prospect of additional revenues from oil will not resolve—or even substantially diminish—the fiscal challenges of meeting the MDG targets.

Against this general background, the present study attempts to address the following issues:

- Examine the key dimensions of government revenues and expenditures and how these relate to MDG-related activities; Assess the impact of positive and negative macroeconomic developments on MDG-related government expenditures;
- Explore opportunities for mobilizing additional domestic resources through taxation, and assess the likely increases in revenue through improved revenue collection and management;
- Highlight potential areas for improved expenditure allocations and efficient debt management; and
- Make policy recommendations for increasing the effectiveness of MDG-related expenditures.

Viewed broadly, these issues can be reduced to a key question: how can Ghana best leverage—i.e. create and use in a strategic manner—'fiscal space' to achieve its human development objectives by 2015 and sustain progress beyond that time?

Recent reports have already provided a comprehensive review of Ghana's policies and progress towards the MDGs, the challenges of attaining Middle Income Country (MIC) status, and a detailed review of Ghana's macroeconomic situation and prospects.[3] In light of the above issues and the question posed, this study will examine the key pillars and determinants of fiscal space, given Ghana's fiscal policy constraints and objectives for the

---

[3] See GoG/UNDP, 2010 on the MDGs and ISSER, 2010 and IMF, 2010, on global macroeconomic conditions and performance, UNDP, 2010 "Potential implications of MIC for development assistance and achievement of MDGs in Ghana."

.

MDGs and human development. The intention is to assist the GoG view the creation of fiscal space to attain the MDGs (and other development objectives) as a strategic tool for more effectively analyzing (and tracking) the dynamics of the economy.

The remainder of the study is organized as follows. Section 1 places the discussion in context by providing an overview of recent socio-economic and policy developments, including MDG progress and prospects. Section 2 sets the stage for a more in-depth analysis of fiscal space by discussing seven key 'known' parameters that characterize and structure Ghana's macro-fiscal and socioeconomic environment. Section 3 examines seven additional issues related to the performance of the economy, which will have a varying though significant impact on the prospects for sustained economic and human development. Section 4 draws on this background to address how the dimensions of fiscal space relate to the role and determinants of fiscal policy achieving continued progress towards the MDGs. Section 5 concludes by outlining possible options and recommendations for moving forward.

Section 1—Context and concerns

Ghana has recorded important—and in some cases impressive—progress on several fronts over the past decade. A recent rebasing exercise undertaken by the Ghana Statistical Service makes Ghana a Lower Middle Income Country (LMIC). The revisions indicate that Ghana's GDP is roughly 75 percent higher than previously estimated.

These new estimates mechanically reduce the level of all indicators expressed as a share of current GDP by about 57 percent compared to their 'initial' level.[4] This statistical change applies, for instance, to the fiscal deficit, the debt ratio, the balance of payments current account deficit and the relative size of the government; similarly for tax effort (measured by domestic revenue over GDP), the investment rate and the savings rate. Further, the revisions require observers to re-assess Ghana's overall human development performance or public sector efficiency against that of countries which are significantly richer than has been done up to the present. Nevertheless, the new GDP estimates do not affect several other indicators and structural features of the economy such as the relative shares of recurrent and investment spending in the budget, the gap between imports and exports or the growth rate of the money supply, interest rates, the rate of inflation, or the exchange rate. While the new estimates are working their way through the system, they have not yet fed fully into the official figures that have been used in this study.

Thus, at this stage, three observations can be made regarding Ghana's progress towards the MDGs. First, progress has been generally satisfactory, but uneven across the various sectors, goals and associated targets. Goal 1 on poverty and hunger has already been met; goal 2 on primary education might be achieved even though education quality is an issue. Goal 3 on gender equality is likely to be met; so will goal 6 on HIV/AIDS, malaria and other diseases. However, goal 4 on child health, goals 5 on maternal health and the sanitation aspect of goal 7 will only be met if there are major renewed efforts by all stakeholders. Finally, goal 8 on international partnerships is also likely to be met due in large part to strong donor support.

[4] 1/175=0.57.

A review of the “key factors contributing to the progress” provided in each section of the 2010 MDG report highlights the difficulties of reaching the targets. One difficulty relates to the general lack of human, technical, and institutional ‘capacities’ required topromote human development. Delivering the services that make a difference in people’s lives and sustain their livelihoods is proving to be difficult. This realization reinforces the point that making progress towards the MDGs is not simply a question of financial resources. A second difficulty is ensuring appropriate services are provided at the local level where they are most needed, including through dedicated programmes, community-based systems and/or targeted schemes. International experience confirms that progress towards the MDGs is more rapid when local engagement and participation are emphasized.

Table 1 summarizes progress and prospects to date.

TABLE 1 GHANA'S UNEVEN PROGRESS TOWARDS THE MILLENNIUM DEVELOPMENT GOALS

Goals	Will goal be reached?				State of supportive environment			
1. Extreme poverty and hunger								
• Halve the proportion of people below the national poverty line by 2015	Probably	Potentially	**Achieved**	Lack of data	**Strong**	Fair	*Weak but improving*	Weak
• Halve the proportion of people who suffer from hunger	Probably	**Potentially**	Achieved	Lack of data	**Strong**	Fair	*Weak but Improving*	Weak
2. Universal primary education								
• Achieve universal access to primary education by 2015	Probably	**Potentially**	Unlikely	Lack of data	**Strong**	Fair	*Weak but Improving*	Weak
3. Gender equality								
• Eliminate gender disparity in primary and junior secondary education by 2005	**Probably**	Potentially	Unlikely	Lack of data	**Strong**	Fair	*Weak but improving*	Weak
• Achieve equal access for boys and girls to senior secondary by 2005	**Probably**	Potentially	Unlikely	Lack of data	Strong	**Fair**	*Weak but Improving*	Weak
4. Under-five mortality								
• Reduce under-five mortality by two-thirds by 2015	**Probably**	Potentially	Unlikely	Lack of data	**Strong**	Fair	*Weak but Improving*	Weak
5. Maternal mortality								
• Reduce maternal mortality ratio by three-quarters by 2015	Probably	Potentially	**Unlikely**	Lack of data	**Strong**	Fair	*Weak but Improving*	Weak
6. HIV/AIDS & Malaria								
• Halt and reverse the spread of HIV/AIDS by 2015	Probably	**Potentially**	Unlikely	Lack of data	**Strong**	Fair	*Weak but Improving=*	Weak
• Halt and reverse the incidence of malaria	**Probably**	Potentially	Unlikely	Lack of data	**Strong**	Fair	*Weak but Improving*	Weak
7. Ensure environmental sustainability								
• Integrate the principles of sustainable development into the country policies and programmes and reverse the loss of environmental resources	Probably	Potentially	**Unlikely**	Lack of data	Strong	**Fair**	*Weak but improving*	Weak
• Halve the proportion of people without access to safe drinking water by 2015	Probably	Potentially	**Achieved**	Lack of data	**Strong**	Fair	*Weak but Improving*	Weak
• Halve the proportion of people without access to improved sanitation by 2015	Probably	Potentially	**Unlikely**	Lack of data	Strong	**Fair**	*Weak but Improving*	Weak
8. Global partnership for development								
• Deal comprehensively with debt and make debt sustainable in the long term	Probably	**Potentially**	Unlikely	Lack of data	**Strong**	Fair	*Weak but Improving*	Weak

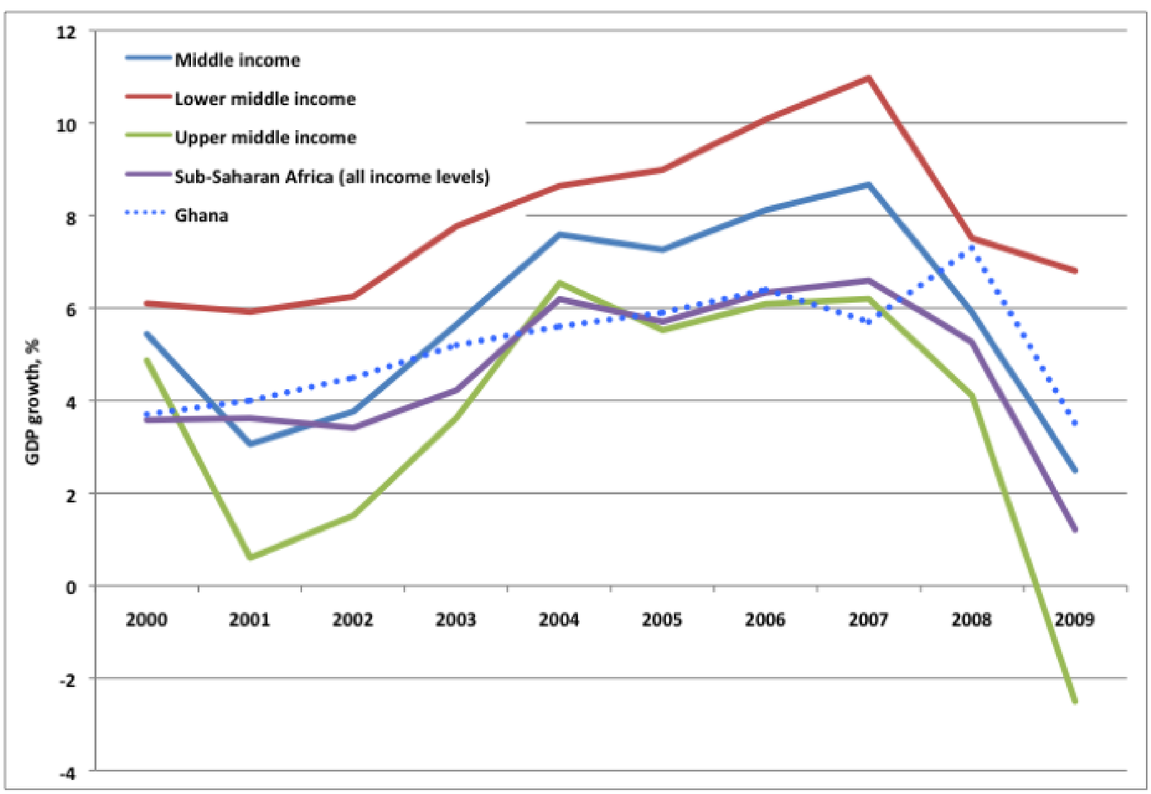
SOURCE: NDPC/GOG/UNDP, 2010

In response to the limited progress in the attainment of MDG 5 on maternal health, GoG has worked with UNCT to develop the MDG Acceleration Framework (MAF). This specifically focuses on family planning, service delivery, emergency obstetrics, and neo-natal care. The total budget for the MAF exceeds $3 million.

A second feature of the context within which Ghana is pushing towards the MDG targets is the macro fiscal stance. As noted earlier, GDP growth has averaged 5.2% per year over the period 2000-2009. This is 0.8 percentage points above the average performance of Sub-Saharan African countries and 0.2 percentage points above that of Low Income countries (LICs). However, it was more than 2.5 percentage points below the average performance of Lower-Middle Income countries (LMICs), as shown in Figure 1.

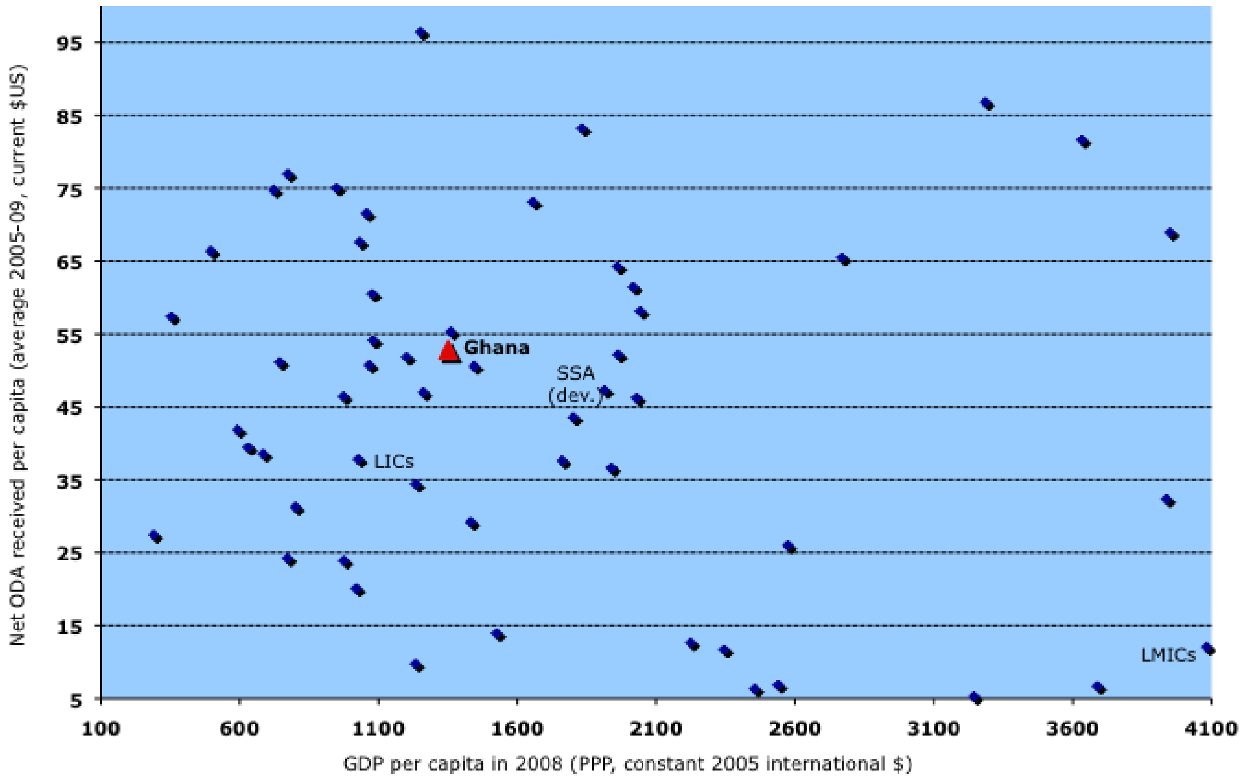
Ghana's relatively high population growth (see section 3) has diluted the income gains in per capita terms, with growth averaging 2.8% per capita (Figure 2). This is to be contrasted with income growth of 1.8% per capita over the same period for Sub-Saharan Africa as a whole, over 2.8% for LICs and 6.6% for LMICs. These differences are significant: for Ghana to have had the same rate of GDP per capita growth as the LMICs, its GDP should have grown at about 8.8% per year instead of 5.2%. Elements that have kept the rate of economic growth lower than it might otherwise have been the fiscal and macroeconomic imbalances. Discussed further below, these imbalances relate to debt, deficits, and the exchange rate.

FIGURE 1: GHANA'S ECONOMIC PERFORMANCE HAS BEEN SOLID, BUT NOT OUTSTANDING: GDP GROWTH IN GHANA AND SELECTED GROUPS OF COUNTRIES, 2000-2009



Sources: WDI, 2010

FIGURE 2: **SOLID BUT NOT OUTSTANDING: AVERAGE 2005-2009 PER CAPITA PERFORMANCE OF GHANA AND SELECTED GROUPS OF COUNTRIES VS. 2005 PER CAPITA GDP**



Sources: WDI,2010.
Note #1: SSA (dev.) refers to Sub-Saharan African developing countries only
Note #2: This Figure and all subsequent Figures based on WDI 2010 include all countries and groups of country for which data was available over the specified range

Third, Ghana has generally benefited from a supportive policy environment both at home and abroad. A democratic transition occurred in 2008 between two governments that, despite differences in priorities, have been committed to economic growth and human development. Ghana has also received large amounts of external financial support, which has been critical in sectors such as health and education. Over the last decade Ghana has specifically benefited from the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), as well as from Multi Donor Budget Support (MDBS) and project support. Both GoG and the DPs have worked diligently to promote human development, but further improvements in performance are possible. The ranking, alignment and coordination of development activities require special attention as a means of raising operational efficiency.

These three broad features—marked but uneven progress towards the MDGs; solid economic performance with large macroeconomic imbalances; and a generally supportive policy environment with ample room for improvement—constitute the overall context within which this study addresses the question: *how can Ghana best leverage fiscal space for the MDGs and human development?*

Indeed, as this study notes, due to recent developments there is a general apprehension that MDG-related funding may decline and progress towards the goals may stall. Specifically, the major budget slippage of 2007-2008, and the combined effects of the global crisis (which followed the oil and food price spikes) have seriously stressed the economy. At the same time, this study underscores the importance of dealing with structural weaknesses and imbalances that these recent events have highlighted rather than created. Accordingly, it is important to gain a realistic understanding of the key parameters that characterize as well as structure the country's macro-fiscal and socioeconomic environment.

Section 2—What we know: key structural parameters

The basic features of Ghana's current economic situation, which determine the prospects for sustained progress towards the MDGs and for boosting human development, have been widely described in several recent reports. This section builds on those studies by examining seven structural 'parameters' that are directly relevant to leveraging fiscal space for the MDGs, and human development more broadly. We refer to them as 'structural parameters' because they are widely acknowledged as pressing issues that do not appear to be susceptible to major changes in the short run. These parameters are: large budget deficits; high relative and absolute levels of total government expenditures; a large stock of arrears to various Funds and contractors due to poor commitment control; a large public sector wage bill; low overall public sector efficiency and capacity; a strong reliance on earmarking of public resources for specific Funds and uses; and a high reliance on foreign aid, especially in certain sectors. Several of these features are inter-dependent with some of them reinforcing their adverse impacts.

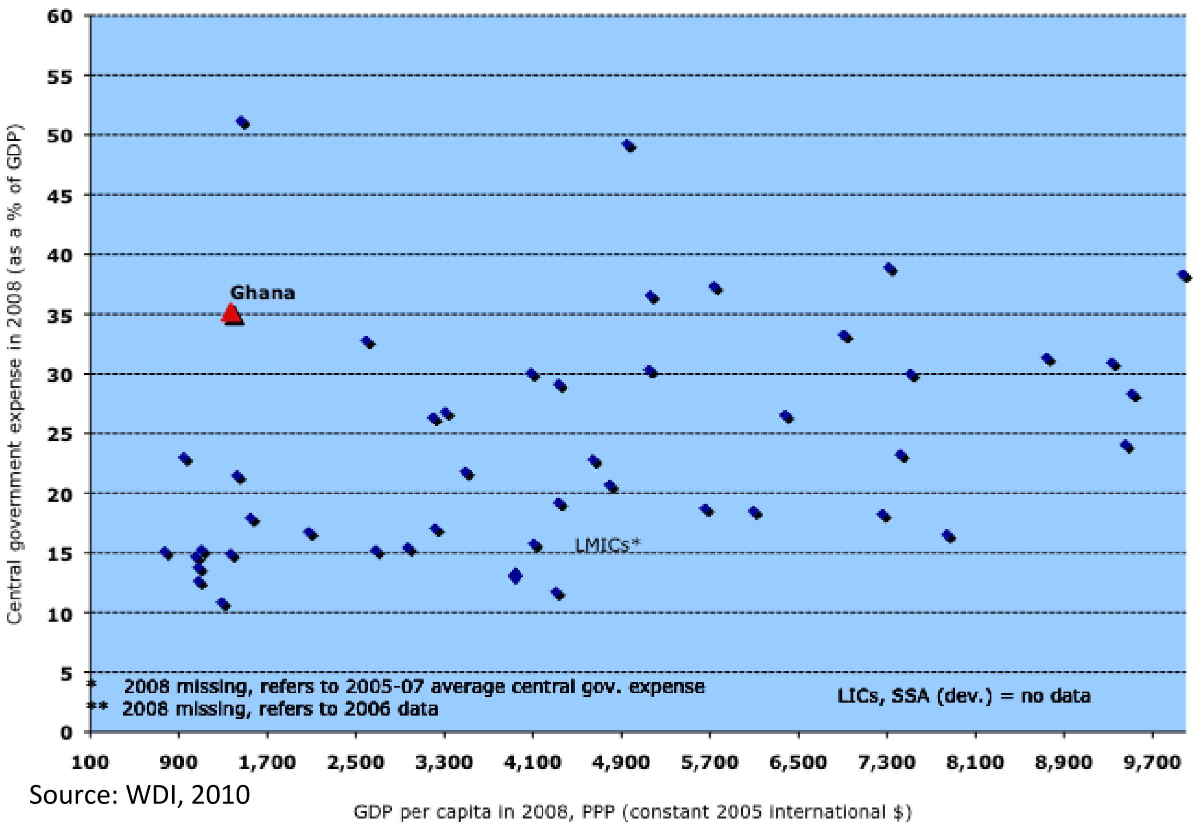
2.1—Large government

As measured by the level of its total expenditure as a share of GDP (before rebasing), Ghana has a large government for the country's level of development (Figure 3). At close to 40 percent, its expenditure share matches that of most OECD countries. The main discrepancy by World standards is in government consumption. In 1995 Ghana, at 12 percent of GDP, was generally in line with other LICs (11 percent) and MICs', at 12 percent (WDI, 2010). However by 2008, Ghana's government consumption was 20 percent of GDP, relative to the LIC share of 10 percent and MIC share of 13 percent. The increase in consumption showed up directly as a decline in savings. In 1995, gross savings in Ghana was 18 percent of GDP, consistent with international norms; by 2008, it was 7 percent of GDP, which was atypical of both LIC and MIC performance.

While high consumption expenditure in both absolute and relative terms is not necessarily a problem, particularly if it is transitional, two issues need to be highlighted. The first is that government expenditure needs to contribute to the overall efficiency of the economy through the services that support and sustain private activity and improve the welfare of the overall population. The second issue is that the composition of government expenditure should create a reasonable balance between the present activities and provisions for the future.

There is extensive evidence that the efficiency of many Government activities is low and that the welfare effects of government expenditure (especially when considered on a regional basis) could be significantly higher. Similarly, the balance between recurrent and capital expenditures shows that the Government regularly emphasizes specific current activities (especially personal emoluments) at the expense of maintenance and operations and the investment required to maintain and expand the economy's productive capacities.

FIGURE 3: **GHANA'S GOVERNMENT IS LARGE BY INTERNATIONAL STANDARDS: GOVERNMENT EXPENSE AS A SHARE OF GDP VS. GDP PER CAPITA IN 2008**



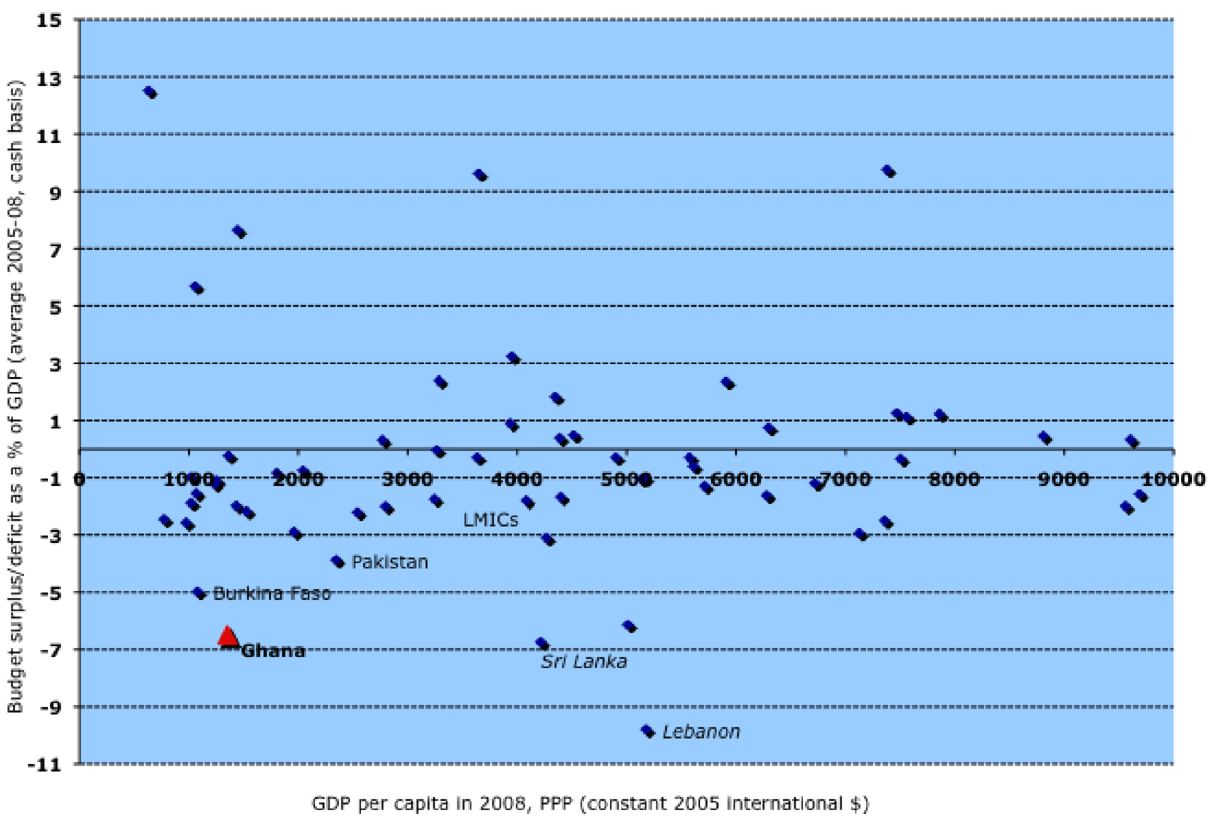
Source: WDI, 2010

Thus, while the rebasing exercise may eventually show that government expenditure is not inordinately "large," it will not change the two features highlighted here, namely, that the efficiency with which the Government uses its resources is generally low, and that the balance between recurrent and capital expenditure has the effect of short-changing the public sector capacities that will be required to raise the economy's rate of growth.

2.2—Budget deficits

A key feature of economic management in Ghana over the last decade has been the high and persistent budget deficit (Figure 4), which peaked in 2008 at 14.5% on a cash basis and over 20% on a commitment basis (IMF and WDI, 2010). This is the mirror image of the decline in savings noted above. Among other things, the budget deficit has accounted for the rapid growth of domestic credit, the crowding out of private sector activity by high interest rates, a chronically high rate of inflation (evidence of which is given below), and general upward pressure on the real exchange rate. The last mentioned undercuts the economy's export capacity, making it impossible for Ghana to balance its external accounts and keep its debt burden within sustainable bounds (despite the massive relief provided by HIPC and MDRI).

FIGURE 4: GHANA'S PERSISTENT BUDGET DEFICITS HAVE BEEN, *ON A CASH BASIS*, THE 3RD LARGEST WORLDWIDE ON AVERAGE OVER THE 2005-2008 PERIOD



Source: WDI, 2010

Each of these elements—deficits, debt, inflation, high interest rates, pressure on the exchange rate—create uncertainty inducing both local and foreign investors to hold back in ways that reduce the economy's growth potential. As already noted, Ghana's success so far has been due to its ability to achieve a reasonably robust rate of growth. Its continued success will require a marked sustained increase in the rate of growth. Budget deficits and their knock-on effects make that prospect exceedingly difficult to achieve.

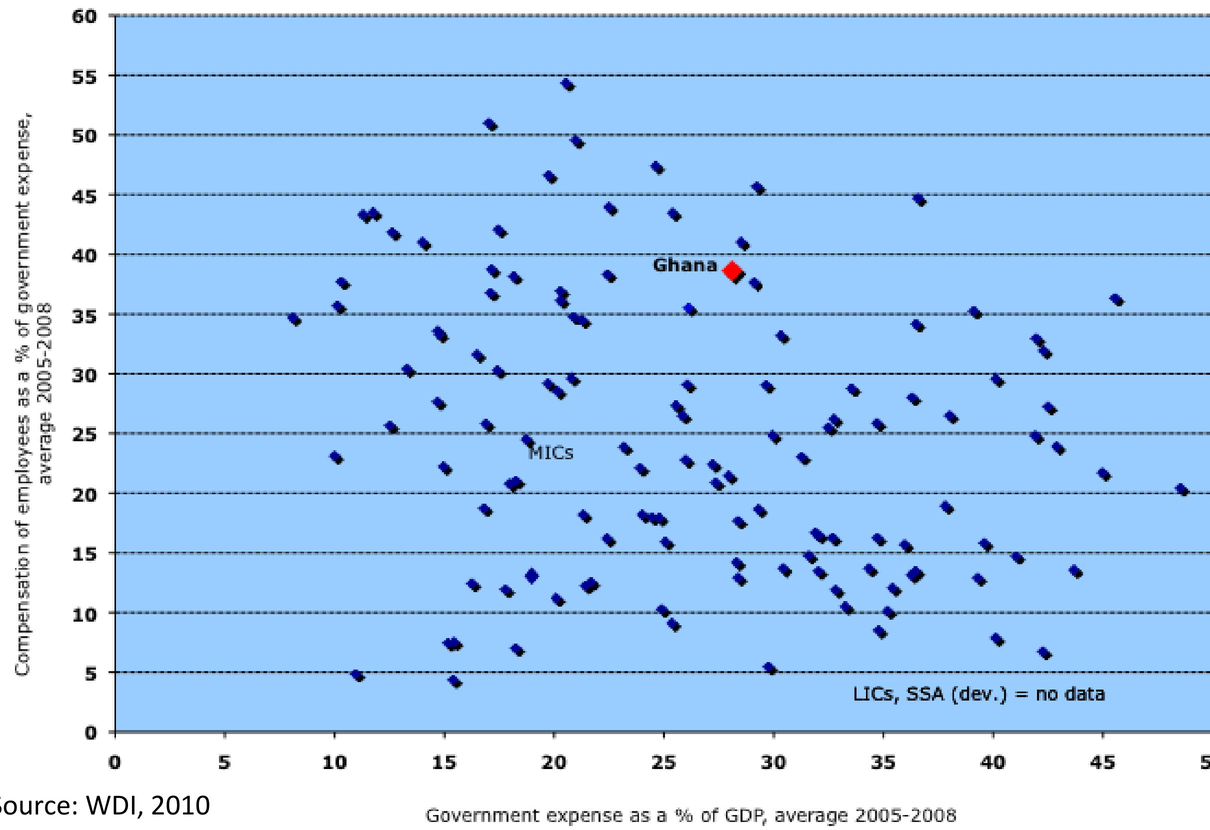
Ghana's average budget deficit remains relatively large even considering the new GDP estimates. Large, persistent deficits—especially of the size being run in Ghana—generally reflect the unwillingness of policymakers to operate within the economy's supply-side constraints, i.e., the revenue and borrowing that are consistent with the country's capacities supplemented by the efficient use of resources provided through foreign aid. The persistent over-extension of government (evident through expenditures that are significantly larger than available resources) has undercut the capacity of the economy to grow faster. In turn, this has diminished the rate of progress the country has made towards the MDG targets, or its ability to surpass them.

2.3—Public sector wage (and salary) bill and other recurrent expenditures

By any standard, Ghana's public sector wage bill is large. Between 2005 and 2008, the public sector wage bill grew from 8% to 11% of GDP. That is, the public sector wage bill absorbs no less than 28 percent of total government expenditure and 50 percent of total government revenue (GSHDA, 2010, WDI, 2010). Preliminary evidence of the effects of the recent shift to a single spine structure suggests that the wage bill will continue absorbing a large share of the budget. Reversing (or even containing) this trend will be a major challenge.

With such a large wage bill, the Government has little flexibility within the budget to emphasize new areas of expenditure when appropriate, to respond to emergencies if needed, and to finance the operations and maintenance activities that are required to ensure that the public sector employees remain productive. Such a large commitment to wages places downward pressure on investment expenditures (infrastructure, training, adaptive research) that supplement the economy's productive capacities. There is a further point related to equity: with around 10 percent of GDP already devoted to wage payments paid to a relatively small group of workers who, by Ghanaian standards are significantly better off than most of the rest of society, few resources remain for the GoG to improve the welfare of the many Ghanaian who are less fortunate. Yet, it is this group which benefits most from improvements in MDG performance.

FIGURE 5: GHANA'S GOVERNMENT SPENDS A LOT FOR ITS LEVEL OF DEVELOPMENT—AND A LOT ON WAGES: COMPENSATION OF EMPLOYEES AS A SHARE OF EXPENSE VS. EXPENSE AS A SHARE OF GDP, 2008



Source: WDI, 2010

The growth in the wage bill has significantly increased recurrent expenditures as a proportion of total government expenditure. That share rose four-fold in 10 years, from 16.4% in 1995 to 67.5% in 2009 (GSGDA, 2010). The dominance of recurrent expenditure in the budget in general, and the weight of the wage bill in particular, have added to the budget deficits thereby crowding out activities that would more effectively promote growth. The trend is worrisome given that there is little evidence of a satisfactory return in terms of service delivery, a point discussed later.

2.4—Arrears

Arrears accumulate when the Government makes commitments without supplying the corresponding financial (cash) resources. There are two types of arrears in Ghana. The first relates to deferral of transfers to statutory funds. The second represents unpaid bills to domestic suppliers and/or contractors. The stocks of both types of arrears continued to grow as recently as 2009 and currently remain significant. In order to keep the fiscal deficit and net domestic financing in line with the ceilings agreed with the IMF, the government added arrears equivalent to 2.4% of GDP to the former and 1.8% to the latter (IMF, 2010). Arrears were 6.5% of GDP at the end of 2009. Roughly 60% of this amount was owed to domestic suppliers, especially in the energy sector (IMF, 2010).

The first type of arrears, deferral of transfers to statutory funds, is essentially an artefact of internal government accounting. It has no substantive negative macroeconomic effects. Indeed, in view of the existing size of the (cash) budget deficit, that some of the intended expenditures from the various statutory funds and trust accounts were not made eased the overall inflationary pressure on the economy. The main macroeconomic effect of under-spending in these areas would be evident in the longer-term if and only if the efficiency of the economy were affected.

It is the second set of arrears—unpaid bills to domestic suppliers—that has important economic implications. Perhaps the most significant is that persistent arrears represent a fundamental breakdown in governance. The Government has made commitments which it does not intend financing in the current year. The arrears could have been paid by additional borrowing, but were not. The accumulation of the arrears gave the appearance that government borrowing was lower. By not making the payments, the Government essentially forced its suppliers to provide it with credit. The suppliers, in turn, typically tap others sources of finance. For their part, State-Owned Enterprises (SOEs) that have not been paid by government often tap State-Owned banks for finance. This indirectly funds the government. The borrowing of Tema Oil Refinery (TOR) from the Ghana Commercial Bank is an example. These adjustments add to domestic credit creation, further exacerbating the economy's chronic inflation which over the period 1990 to 2008, averaged more than 20 percent per annum (WDI, 2010). Current inflation in Ghana, though lower, is well above comparable international norms (IMF, 2010).

A typical consequence of the build-up of arrears, which is not specific to Ghana alone, is that the arrears sets up some adverse political economy dynamics with the domestic suppliers who have been forced (through the arrears) to extend credit to the government. Private enterprises that have not been paid often use that fact as leverage for favourable access to new government contracts. These contracts often have inflated costs to cover the arrears. In these circumstances, the government (and the economy) pays twice. In all instances, efficiency is reduced, lowering the economy's capacity for growth.

2.5—Heavy Dependence on ODA

Ghana's reliance on ODA is high, especially in key social sectors. In 2008, Ghana received \$52 in (net) ODA per capita, in contrast to only \$12 per capita for LMICs, \$37 for LICs and \$47 per capita on average for Sub-Saharan Africa (WDI, 2010). Net ODA flows amounted to 8.4% of GNI, above the average for LICs (7.4%). By contrast, the average for LMICs was 0.4%. In 2009, ODA flows were equivalent to 43.4% of domestic revenue and 11.4% of GDP and accounted for 26.8% of the total budget (CG Discussion Document, 2010). Ghana's reliance on ODA varies greatly by sector, with the health and education sectors receiving most support. For instance, direct donor assistance to the education and health sectors were respectively 7.8% and 11.2% in 2008, and 7.6% and 14.3% in 2007.[5] It is important to mention here that these ratios reflect changing modalities with donors preferring to channel support through the Multi-Donor Budgetary Support mechanism: in effect, donor support to these two sectors is higher than these ratios suggest. This again raises questions of governance: two of the key sectors upon which the future growth and human development of Ghana depend, namely education and health, are being supported more heavily by the international community than the local authorities. Observers may enquire how can this reflect a constructive national strategy for supporting key components of the MDGs?

2.6—Earmarking

The practice of earmarking or designating specific revenue sources—or, in Ghana's case, specific shares of particular revenues—for particular purposes is widely used in budget management the World over. Ghana employs the practice extensively. Examples include

[5] This excludes indirect support through the MDBS and is based on data obtained from the Aid and Debt Management Division (ADMD) of MoFEP

the District Assemblies Common Fund (DACF) established in 1992, Ghana Education Trust (GET) Fund in 2000 and the National Health Insurance Scheme (NHIS) in 2003.

Earmarking has pros and cons. It may increase public buy-in (or citizen acceptance) when taxes or fees are raised, thereby easing their introduction. For example, car-owners more readily accept increases in petrol taxes when some or all of the proceeds are earmarked for the construction and maintenance of roads and bridges. Another potential advantage of earmarking is to raise expectations of performance that improves public sector accountability. A further advantage is to guarantee funding for sectors perceived as essential, such as education and health. Finally, earmarking specific funding, especially for long-lived activities, enables the relevant agencies using those funds to focus their attention on improving efficiencies without the pressure of dealing with the annual funding cycle.

There are also several disadvantages. Earmarking reduces the overall flexibility of the budget, especially if the earmark has no “sunset” provision. Earmarking generates an additional level of bureaucracy with the formation of boards and hiring of administrative staff to oversee allocation and monitor performance. Since funds are fungible, earmarking requires additional government oversight to ensure that the resources are used for the intended purposes. Earmarking does not necessarily improve the efficiency of resource use, especially when efficiency is not a feature of all government operations. There is considerable disquiet within Ghana, among officials and the general public, regarding the limited impact and evidence of waste in the use of earmarked funds. Indeed, it is seen as a counterweight to the advantage of more secure funding noted above. The relevant agencies become complacent and over-staffed precisely because they experience no funding pressure. In the case of Ghana, the GETFund has been under intense criticism in 2010, following the publication of a report assessing its performance over the past decade.[6]

On balance, as discussed further in Section 5, the extensive use of earmarking limits the scope for using the budget as a strategic policy tool.

---

[6] GETFund Review and Outlook (2001-2009)

2.7—Low overall efficiency and productivity

Ghana has serious problems with efficiency and productivity. In general, returns on inputs are low. This point is especially worrisome if, indeed, Ghana's GDP is 75 percent larger than previously estimated. Public sector's efficiency—defined as achieving the highest expected outcome from a unit of labour time and/or resource—is routinely questioned both within and outside the Government. In this respect, Ghana is an example of the problems created by failing to match the development agenda with the government's (financial, institutional, human, physical, and organizational) capacities.

Discussed extensively in the 1997 World Development Report "The State in a Changing World," this issue has been a reminder for all developing countries that a principal source of public sector inefficiency is government over-reach. For example, inefficiencies are widely recognized in the Ghanaian education sector. Despite 25% of the budget spent on teachers (including salary, paid study leave, and sponsored distance education), the quality of education remains low, especially in rural areas. There are many problems (e.g., teacher absenteeism measured in some studies exceeds 20%). The consequences are serious. Ghana is likely to meet the MDG for primary school enrolment with few of the teachers having gained the necessary teaching skills and students having achieved few of the appropriate levels of learning.

The size of the government (referred to earlier) helps explain the limited role of the private sector and the rapid growth of the informal sector. At the macroeconomic level, high budget deficits have contributed to high interest rates which sharply reduce access to investment financing. It is also the case that extensive public sector involvement can prevent or slow down the development of small-scale private entrepreneurs. Blocked by government engagement or influence, private operators are often confined to a limited range of activities. The outcome is that, aggregate public sector productivity is low in Ghana. It is well below that of Mauritius and Botswana (the leading African economies in this area)—and lags behind that of most fast growing East and South East Asian countries (NDPC/GoG/UNDP, 2010). Agricultural productivity is especially low, with limited application of fertilizers, minimal use of irrigation, and the weak spread of productivity-improving techniques and technology (NDPC/GoG/UNDP, 2010).

Overview:

These structural elements significantly restrict the actions of the GoG and the DPs in generating and spending additional resources to support the activities that contribute to attaining the MDGs. The budget deficit constrains activity in several ways. First, by accelerating the growth of credit and debt it adds to Ghana's chronic inflation, generates uncertainty, raises costs within the private sector, and holds down the rate of growth. Moreover, with a large deficit, the Government is under intense pressure from DPs to "consolidate" its fiscal situation. Indeed, the current agreement with the IMF is designed to reduce the budget deficit (on a commitment basis) to 3% of GDP.

Second, with the Government sector already large by comparable international standards (and kept large by a public sector wage bill in excess of 10 percent of GDP), the Government has no scope for increasing its own expenditure. Accordingly the suggestion that Ghana adopt a counter-cyclical fiscal policy as a means of generating fiscal space for the MDGs in the wake of the 2007-09 global financial and economic crises is untenable given the historical pattern of deficits, rapid growth of credit, and debt levels that have placed Ghana back on the international "debt watch" list. Any effort to raise the rate of growth will have to come from the scaling down of Government in way that provide opportunities for the private sector to expand.

Third, the arrears problem reflects poorly on internal Government controls. Under the IMF program these arrears are meant to be cleared by 2013. This will be supported by improved administrative mechanisms, especially the Ghana Integrated Financial Management System (GIFMIS), which is expected to become fully operational over the next five years.

Fourth, Ghana's dependence on aid needs to be seen in broader context. As a short to medium term boost to development prospects, heavy reliance on aid (the experience of Taiwan, Korea, and Malaysia during their early years of rapid development) may be an appropriate strategy. Nonetheless, continued over-dependence on aid (a clear risk for

Ghana at this point of its development) can have negative feed-back effects. Specifically, it can shift the problem of development from being Ghana's responsibility to one where the DPs begin to see it as their responsibility for ensuring that Ghana "hits its targets" (such as the MDGs) or takes the measures needed to rebalance the economy. The fundamental point that needs to be maintained is that Ghana's pattern of development is its own business. For this reason, leveraging fiscal space to support the achievement of the MDGs could be seen as a useful starting point. All Ghanaians will recognize that the country is truly on a sustainable growth trajectory if the MDGs are supported in a fiscally sustainable manner.

Fifth, key elements in promoting such a growth trajectory will be the success of Government efforts to improve efficiency. The current situation produces waste and excess. Too many public sector workers are being too heavily subsidized (even if they individually perceive their overall wages to be low) and too many public sector agencies are being supported despite large losses. Growth can never be rapid or sustained when large parts of the economy, through the public sector, subtract value. Indeed, just by stopping these activities, GDP will rise. (Recall that GDP is the sum of value-added generated by every individual and enterprise within an economy.)

Section 3— Additional Considerations Related to Fiscal Space

The following questions are relevant to the creation and use of fiscal space: what will be the effect of oil on Ghana's growth and development trajectory?; Is Ghana already or about to become an MIC—and what difference does it make?; Is Ghana's tax effort relatively high, or too low?; What are its demographic prospects and what implications do they have?; What are the key constraints to raising Ghana's rate of economic growth?

3. 1—What might be the effect of the exploitation of oil?

The oil and gas find in Ghana have advantages and disadvantages. Some observers argue that the oil discovery will help resolve many, if not most, of the country's problems. An obvious advantage is the expected increase in income, part of which will translate into additional government revenue, a heritage fund and a stabilization fund. Others see an advantage in lower fuel costs helping to reduce transport costs and increase national, especially regional, integration. By contrast, other observers warn of the 'resource curse': experience indicates that the management of revenue from natural resources (particularly oil production in Africa) has been associated with the lack of fiscal transparency and weak budget control and poor governance (Moss and Young, 2009).

There are now many studies about the potential impact of the exploitation of petroleum resources on Ghana's economy and society (for example, Osei and Domfe, 2008, Breisinger *et al.* 2009, and Moss and Young, 2009, IMF and World Bank). Current estimates by the World Bank and the International Monetary Fund show that oil will provide about US$1 billion a year over the next two decades. Additional discoveries, if they occur, will extend the benefit. The economic effect in terms of income generated and revenue produced might be likened to a decade long tripling of the cocoa price, or sustaining the gold price at its current level (above $1,300 per ounce) for several more years. As respective proportions of projected tax revenue and fiscal deficits for 2010, the estimated oil revenue will be 23% and 72%. To help place the flows in perspective, the revenue from oil will be equivalent to roughly 51% and 36% respectively of cocoa and gold exports.

These data show that, although important, oil revenue will not resolve Ghana's fiscal challenges. Oil revenues will help; but to do so, they will need to be used efficiently and selectively and in ways that explicit add value.

TABLE 2: OIL REVENUE AND SELECTED FISCAL INDICATORS

	2010 Fiscal Estimate (US$ million)	Oil Revenue (% of 2010 fiscal indicator)
Tax Revenue	4,337	23%
Total Exports	6,124	16%
Overall fiscal deficits	-1,389	-72%
Cocoa Exports	1,978	51%
Gold Exports	2,799	36%
GDP	18,524	5%

Source: Authors' calculations of the ratios based on fiscal estimates from GoG Budget 2010 and World Bank oil revenue estimate of US$1 billion a year. All figures are rounded to the nearest unit.

It is also noteworthy that none of the projected outcomes indicate that oil will catapult Ghana to *upper* middle-income status within a decade or two. The current estimates show that Ghana will gain from the discovery of oil (if the resources are efficiently used) and that gain will, at best, raise Ghana's per capita income to a level roughly equivalent to that of countries which are in the lower segment of lower middle-income status. That is, even though oil will help raise Ghana's per capita income, the increase over the next two decades will be approximately 40 percent based on the current level of GDP but significantly less on the rebased level (World Bank 2010, Figure 1.1; IMF 2010, Text Table 3, page 10). This is an important addition to national income, but it will not be developmentally transformative. Ghana will still face the "hard pounding" that all developing countries confront in creating the conditions which promote and sustain human development over the long term. As the IMF and World Bank have pointed out, despite increased revenue from oil, the country will need to reduce its large deficits in order to improve upon its less than favourable debt sustainability outlook.

There is also a serious risk of Dutch disease. To counteract that, some observers have suggested a 'direct cash distribution of oil receipts' (Moss & Young, 2009). Others in Ghana have dismissed such a proposal as unworkable and one that would not lead to sustained development (Idun-Arkhurst, 2009). We suggest that some variant of this proposal is worth further review, especially if it helps promote favourable behavioural changes in the population. We return to it in section 5.

3.2—Is Ghana already, or will it soon become an MIC?

The exploitation of oil is expected to produce a 20% jump in GDP in 2011 (IMF, 2010; World Bank 2009, Table 3). Real GDP growth is projected to remain slightly above 5% over the medium term (up to 2014). Ghana is likely to register a large increase in per capita GNI relative to its present estimate of $630 in 2008 prices (World Bank WDI, 2010, Table1.1) that may place the country above the LMIC threshold of $996. The rebasing exercise has already pushed Ghana past that mark. The basic question is what substantive difference the change will make, especially with respect to MDG performance? Rebasing of GDP is an exercise which all countries undergo periodically resulting in the inclusion of updated estimates of activities that have been systematically neglected in surveys of economic activity. Obvious examples in Ghana include mobile communications, the emerging oil service sector, and the host of personal and professional services and other activities that comprise the SME and informal sector. The GDP estimates recently announced by the Ghana Statistical Service raise GDP by about 75 percent. This puts Ghana into the LMIC group.

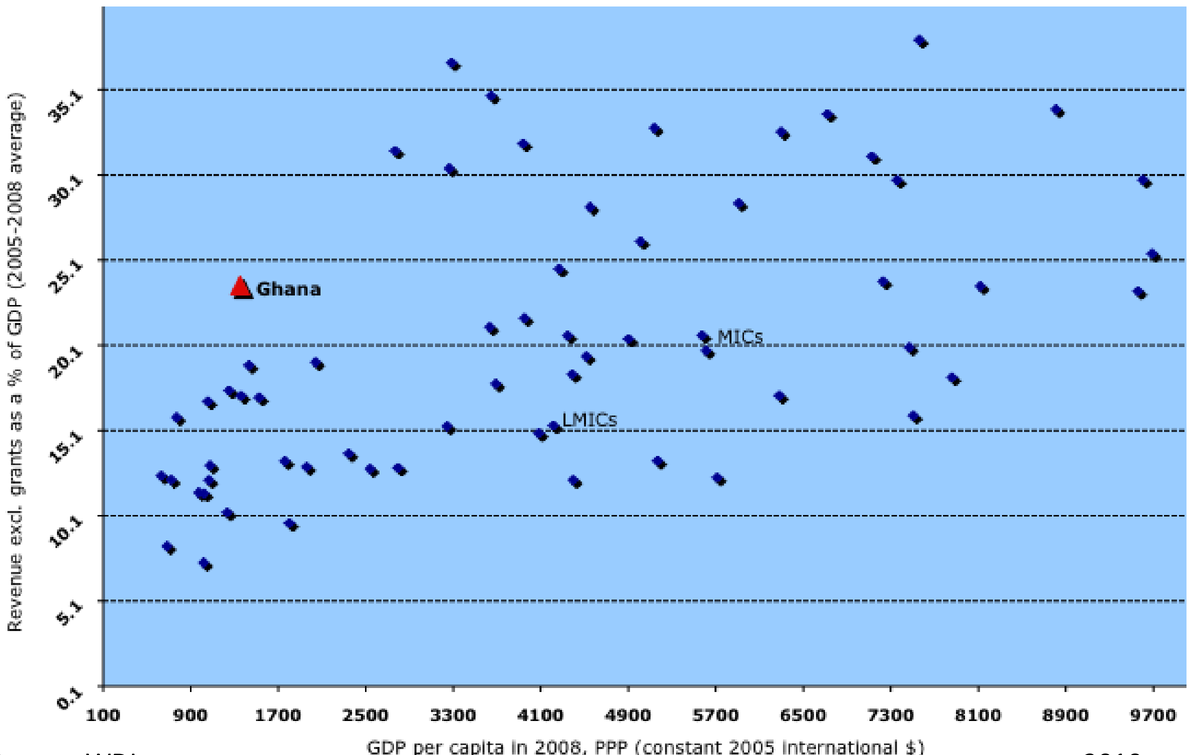
Attaining MIC status has advantages and disadvantages. At present recorded levels of income, Ghana's performance relative to the MDGs is markedly above that of comparable low income countries yet well below that of LMICs, even when the comparison is confined to Sub-Saharan Africa (World Bank WDI, 2010, Tables 1.2, 1.3, 1.4). Furthermore, the jump in Ghana's per capita GNI does nothing to affect its current or projected progress towards the MDGs since none of those targets is directly tied to income (whether GNI or GDP). Ghana will still have just as far to go to reduce extreme poverty, improve food security, and so on as highlighted in Table 1 above.

One specific disadvantage relates more to perceptions. Ghanaians generally may wonder why, if their country is so much richer, personal and national welfare isn't higher. Perhaps a more tangible disadvantage is that when Ghana attains middle-income status, its access to concessional donor flows and donor assistance will diminish. All donors expect countries to provide a larger share of resources for their own development as they get richer. As aid flows diminish, Ghana will have to rely increasingly to borrowing externally on commercial terms and generating additional revenue internally. A final disadvantage is that although an increase in income will reduce the ratio of public sector wages to GDP (making that datum less extreme by international standards), it does not alter the ratio of public wages to tax revenues or modify the efficiency and effectiveness of the public service. Indeed, it is likely to set off a round of adverse public criticism: if Ghana is now so much richer, why isn't the Government delivering more services of higher quality and broader coverage?

3.3—Is Ghana's tax effort high or (too) low?

Another important issue is the level of 'tax effort' in Ghana. Relative to current estimates of GDP, the share of government revenue—which includes tax and non-tax revenues—is high for a country with Ghana's level of development (WDI, 2010, see Figure 6).

FIGURE 6: **GHANA'S OVERALL TAX (AND NON TAX) EFFORT APPEARS RELATIVELY STRONG BY INTERNATIONAL STANDARDS**



Source: WDI, 2010

Based on these data, there appears to be little additional scope for raising resources through higher taxes and fees in the short run. Yet, as already noted, the 'rebasing' exercise may modify this conclusion. With rebased GDP, Ghana's 'tax' effort may be closer to 15 percent than to 25 percent. In Figure 6, Ghana would fit into the cluster of countries in the lower right of the diagram. Recent commitments by the Government to close numerous loopholes in the tax system would enable the tax effort to expand.[7] In the medium to long run, an effective tax effort of 25-30 percent of GDP may not be out of reach, as suggested by Figure 6.

Although raising tax effort is something Ghana's policy makers may contemplate over the medium term, the immediate problem for Ghana is that its current tax effort—and general ability to raise resources in non-inflationary ways—is too low relative to government

[7] For instance, GoG 2010 Budget statement refers to a move towards electronic issuance of permits and exemptions to help reduce leakages (GoG, 2010: p-305)

expenditure. The priority for Ghana in the short run should not be to raise taxes and fees but to rationalize the allocation recurrent expenditure and pattern of revenue generation so as to better align the country's projected resource base with the objectives of fiscal policy.[8] But if the rebased tax effort is indeed below 15 percent of GDP, raising domestic revenue can and must be a medium term objective for Ghana as part of a negotiated aid exit strategy.

3.4—Will traditional DPs scale back their support in the foreseeable future?

The scope and pattern of donor engagement in Ghana (through the government, civil society, and the private sector) has been fundamental to the performance achieved so far. With net ODA on the order of $1.5 billion per annum over recent years (averaging around 10 percent of GDP), the impact of the DPs has been significant and in some areas—education, health, and food production—instrumental in moving Ghana towards the MDG targets. The basic question related to the role of the DPs as 2015 approaches is whether there is likely to be any significant scaling back of assistance in response to Ghana's rising income from the combined effects of GDP rebasing and the exploitation of oil? Over the longer term, the main issue is for Ghana and the DPs to negotiate and implement an orderly, coherent, aid exit strategy.

As already noted, LMICs receive substantially less aid as a share of GDP and in per capita terms than LICs. Based on World Bank data, the difference is striking. In 2000, LICs received on average aid of $18 per capita; for LMICs it was $5 per capita. Corresponding data for 2008 were $42 and $10 per capita, respectively (WDI, 2010). Moreover, as also noted, with oil revenues beginning in 2010 expected to average around 5 percent of GDP before rebasing (IMF June 2010, Table 3, page 10), the case for continued large net aid flows to Ghana (when set against pressing needs elsewhere in the World) will be increasingly difficult to justify. For these reasons, the scaling back of DPs in the medium term appears inevitable. Seen as evidence of Ghana's development success, such a scale-

---

[8] For example, higher taxes on large vehicles and petroleum (a revenue effect) would diminish pressure on existing infrastructure and the need for its expansion especially in urban areas (an expenditure effect).

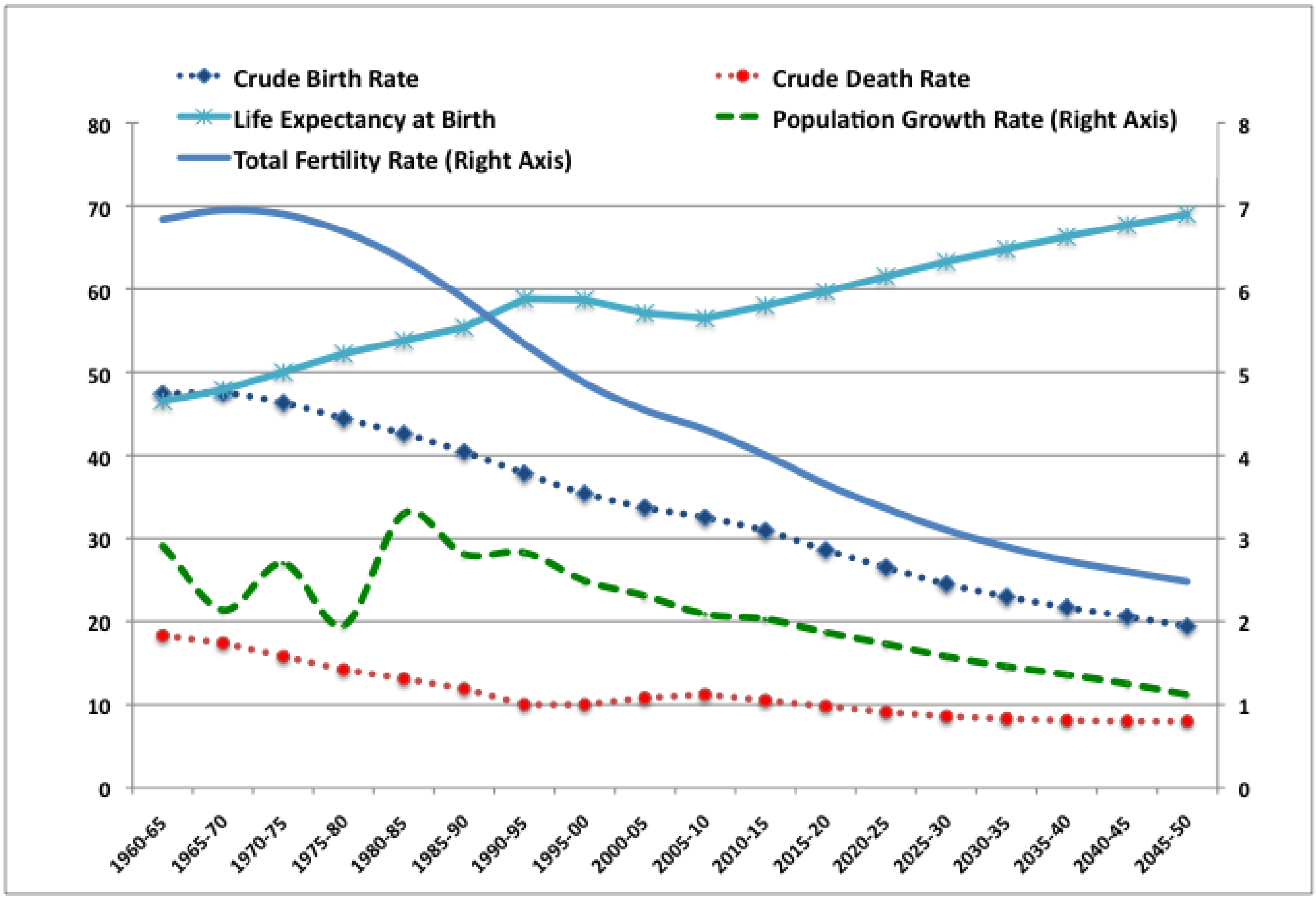
back has several implications that require careful preparation, a topic discussed further in section 5. At this point, there are few indications that significant reductions in aid will occur before 2015.

There is also little indication that, as traditional DPs scale back their support, non-traditional partners such as Korea and China will scale up their aid to an equivalent extent. Several reports in the local media suggest that these countries are in the process of negotiating large loans to Ghana. These, however, are not the equivalent of the grant and concessional loans (e.g., from the World Bank) that are presently provided by DPs.

3.5—How may projected demographic trends affect Ghana's development prospects?

What challenges and opportunities are associated with projected demographic trends? Will the changes in the size and age structure of the population, and its internal distribution through migration, provide a boost to growth and development? With respect to the size and structure of the population, three points are worth making in light of the projections made by the UN Population Division. First, Ghana appears to be well into its demographic transition, and its population growth rate should continue to decline under the influence of falling fertility (Figure 7). Nevertheless, population will continue to grow at a high rate by global standards—by close to 45 percent between 2010 and 2030 according to the UN Population Division's 'medium variant'. This will dilute any gains made in GDP.

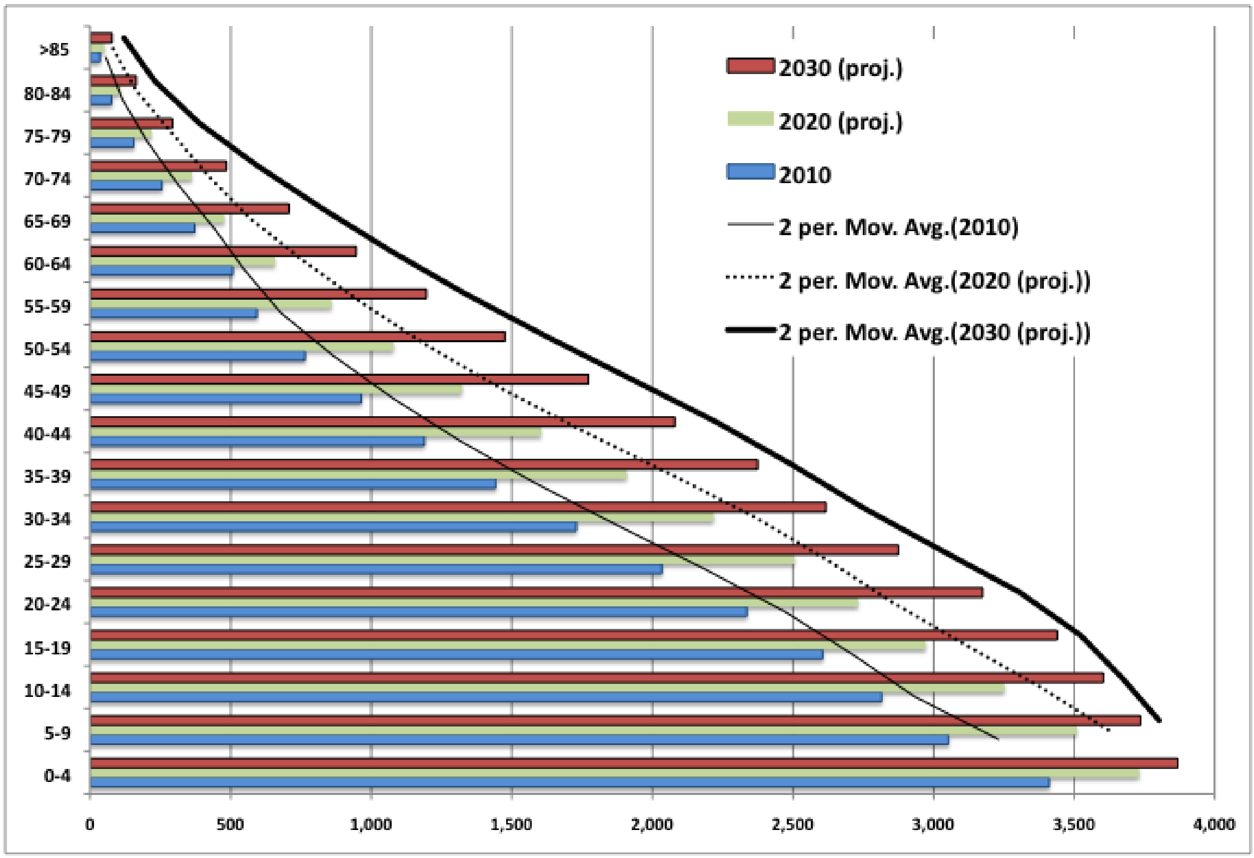
FIGURE 7: **GHANA IS WELL INTO ITS DEMOGRAPHIC TRANSITION, BUT ITS POPULATION GROWTH RATE IS PROJECTED TO BE 1.5—2% FOR ANOTHER 2 DECADES**



Source: UN Population Division, 2008

Second, as a result of falling population growth rates, Ghana will experience a 'demographic bonus' or 'dividend', through an increase in the share of population of working age. This phenomenon is illustrated in Figure 8, which shows that Ghana's age pyramid becomes 'fatter' around its waist. Specifically, the age groups 25-60 grow more rapidly than the others. The age group 25-60 is expected to grow by 65 percent over the next 20 years—from about 8.8 million to close to 14.5 million. This can be an advantage —as in South East Asian countries—or a disadvantage—due to the problems created by 'youth bulge' described in the conflict literature. The outcome depends on the availability of jobs and other economic opportunities for young adults as they enter the labour force. Both phenomena provide added impetus for improving efficiency and raising the rate of economic growth.

FIGURE 8: **GHANA IS ABOUT TO EXPERIENCE A DEMOGRAPHIC 'BONUS': PROJECTED CHANGES THE COUNTRY'S AGE STRUCTURE OVER THE NEXT TWO DECADES**

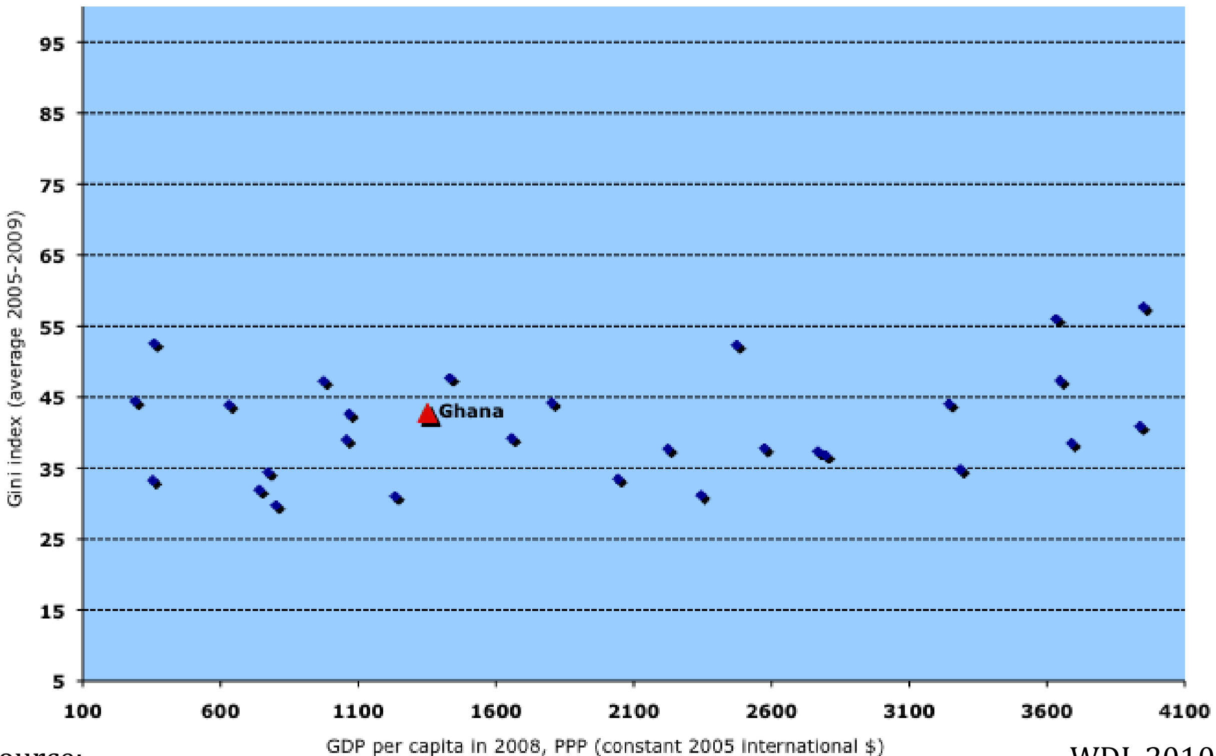


Source: UN Population Division, 2008

The third point is that the fastest growing age group is projected to be those aged 60 and above. This group is expected to grow by 90%, to 2.6 million by 2030. Actual outcomes will differ but much of the population dynamism is already built in. Taken together, the population will increase substantially; there will be a demographic dividend; and the size of the older cohorts will increase significantly. For Ghana, dealing with these changes will require a significant shift in policies and some major social adjustments. Whatever happens, sustained economic growth and expanding job opportunities will be essential.

An additional demographic-economic issue worth mentioning is that of internal migration responding to inequalities of income and opportunities between the Northern and Southern parts of the country. This is likely to be exacerbated with oil production in the southern part of the country.

Figure 9: Ghana's "vertical" inequality level is not uncommon for its level of development



Source: WDI, 2010

When viewed in aggregate, the overall income/consumption inequality in Ghana, measured by the Gini coefficient or the ratio of the income share in the top to bottom 20 percent of the population, is broadly consistent with other LICs and generally better than for comparable countries in SSA (Figure 9). Nonetheless, significant additional disparities exist between the development opportunities in the North and South of the country and the general pattern of privilege reinforced by government policy. Two examples directly affecting MDG performance are the subsidies on energy which do not necessarily benefit the very poor and isolated (since they are not connected to the grid) and the insider/outsider distortions that accompany government employment. These disparities are stimulating internal migration to wealthier regions including Greater Accra. They are also lowering Ghana's growth potential by absorbing public investment simply to maintain living standards (sanitation, water supply, transport infrastructure) in the urban areas. Addressing these specific challenges will require appropriate economic management (including a strategic use of fiscal space).

3.6—What are the domestic constraints to promoting structural change?

An issue that regularly arose in our discussions with various officials and people outside government was the apparent political difficulty of taking and implementing decisions required to improve the economy's performance, raise its rate of growth, and generate broad increases in economic opportunities across the country. Several matters recur: adjusting energy costs to enable the State-owned Ghana Power Company to cover it full costs of operations; rationalizing the government wage bill; reducing the budget deficit to sustainable levels; ensuring that revenue and expenditure policies are mutually consistent and reinforcing; diminishing the Government's reliance on debt financing; and shifting more local resources to support areas now heavily financed by DPs.

Each of these influences the capacity of the country to generate the conditions needed to support substantially higher, sustained rates of economic growth. Yet, each of them poses political economy challenges that have tended to block or deflect purposeful action. It is beyond the scope of this paper to suggest how these challenges might be addressed. It can, however, be noted that each of them has important effects on the economy's capacity to grow and to generate the fiscal space that will support future rapid growth in Ghana and progress towards the MDGs.

For example, low energy prices (to customers) actually increase the costs of energy to the economy through waste, misallocation, and distorted market signals. The large government wage bill diverts resources from productivity-enhancing investment, rewards inefficiency, and reinforces inequalities in the personal and regional distribution of income. A persistent budget deficit (accompanied by arrears) reflects weak revenue generation and expenditure monitoring systems and even weaker governance. Persistent arrears are clear evidence that the government cannot match its expenditures to its available resources. Inconsistent revenue and expenditure policies generate regional distortions (encouraging migration to urban areas) and lead to inflated investment needs simply to maintain existing levels of urban welfare. These circumstances undermine growth by sustaining the economy's inflationary bias, keeping interest rates high, diverting resources from private enterprise, depleting national savings, and allowing macroeconomic instability to persist.

No one doubts the political difficulties (and costs) of addressing each of these issues. It is worth noting however that *not* dealing with the issues also has high costs, especially since the current conditions undermine Ghana's progress towards the MDGs. Indeed, by diverting resources that potentially could be used to support MDG-related activities, they diminish performance and delay the time when the MDGs and other development goals can be met.

3.7—What are the bottlenecks and impediments to sustained higher rates of growth?

What has to be done to raise Ghana's growth rate from the 5-6 percent achieved over the last two decades to the 7-8 percent required to raise economic performance in ways consistent with moving the country forcefully into middle income status and making sustained progress towards the MDGs by 2015, and human development beyond that date? The earlier discussion has already highlighted the challenges and opportunities Ghana faces in raising its sustained rate of economic growth. With population projected to continue growing at a rate of about 2 percent per annum, the target rate of economic growth required to generate the resources required to meet the MDGs (and other social objectives) is indeed on the order of 7 to 8 percent per annum. This may be a tall order, especially considering the new GDP estimates as a starting point, but it is not out of reach.

Elements that will support this rate of growth on a sustained basis include an increase in investment from its current levels, continued rapid expansion of agriculture (to guarantee national food security and boost exports), a marked improvement in labour productivity (derived in part from improved health and increases in the quality of education), improved access to credit by the private sector, rationalization of low productivity SOE operations, and significant reductions in the transactions costs (including transport and communications) throughout the economy.

Making these changes will involve an increase in domestic savings, a reduction in macroeconomic uncertainty (through the elimination of chronically high inflation, shifting towards a balanced budget, and containing public sector debt, especially SOE debt), raising the quality of education, deepening the education system by increasing enrolments at the secondary and tertiary levels, and the strategic development of infrastructure (Fan 2005; IFPRI 2005).

Section 4—Options for leveraging Fiscal Space for the MDGs in Ghana

This section examines whether and how Ghana could create and use 'fiscal space' given the challenges highlighted above and the Government's development objectives, particularly those related to achieving the MDGs by 2015. We begin by reviewing the concept of fiscal space and its relation to the constraints and objectives of fiscal policy. We then examine the 'pillars' of fiscal space in the context of Ghana, assessing the prospects for each of them. Finally, we offer suggestions for creating fiscal space to support the MDGs that will enable Ghana to move forward.

4.1—Fiscal space and policy along the developmental transformation: where does Ghana fit?

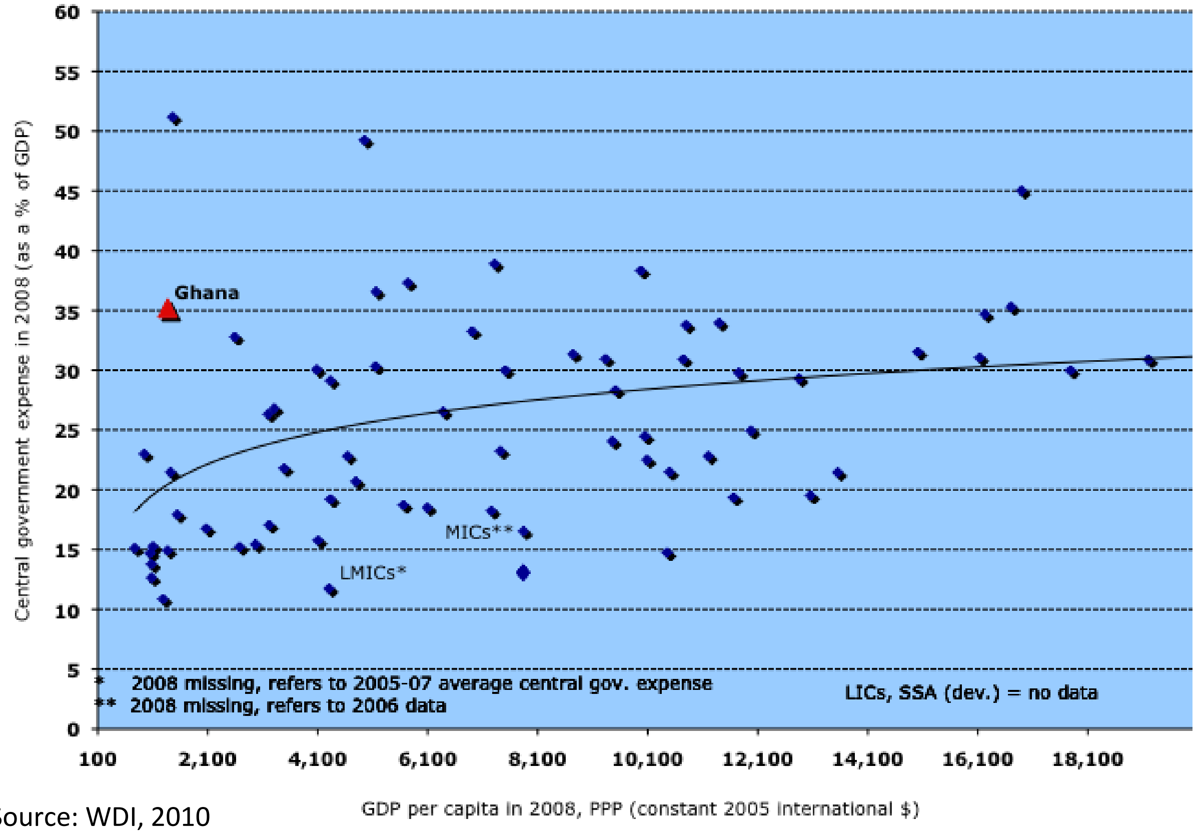
Fiscal space has been defined in several ways, with slightly different 'political' flavours. A definition by Peter Heller is "room in a national budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy" (Heller, 2005). According to Roy et al. (2006) "Fiscal space is the financing that is available to government as a result of concrete policy actions for enhancing resource mobilization, and the reforms necessary to secure the enabling governance, institutional and economic environment for these policy actions to be effective, for a specified set of development objectives." There are subtle differences between the two. The latter definition places greater emphasis on the active role of policy in creating and using 'fiscal space' for a desired purpose relative to what would be available in the absence of these actions. By contrast, the first definition is more prudential in nature, placing greater emphasis on pre-existing conditions.

In reality, the approach adopted will hinge on economy-specific conditions and the objectives assigned to fiscal policy within a given socioeconomic setting. Those objectives vary with the level of economic and human development. Roy *et al.* (2007) examined the features and implications of two 'stereotypical' scenarios—one applicable to the majority of MICs and another relevant to the majority of LICs. In the former case, fiscal policy is primarily concerned with managing the downside caused by structural shocks and addressing development objectives "*principally by fostering the inclusivity of the* *development process*". Under such circumstances, fiscal policy is focused on the stabilization, allocation and redistribution functions of public finance (Musgrave, 1959) for which "… *there is unlikely to be a substantial permanent increase in the size of the government in the economy".* On the domestic revenue side, "*there is unlikely to be a significant permanent increase in the public sector borrowing requirement […] or structural changes in the pattern of resource mobilization or a permanent increase in the size of the public sector."* The second situation, common to most LICs, occurs when "*the objective of fiscal policy is to finance a sustained, significant and permanent increase in public investment to support economic growth and deliver the basic necessities to secure a development transformation"* over one or more decades. The 'growth' and 'allocation' functions of fiscal policy then predominate, implying a permanent increase—including with initial ODA support—in public expenditure as a share of GDP over the long run.

Key questions are: where does Ghana fit in, and what are the implications for the role and resources of fiscal policy in Ghana? And, given that Ghana is in the process of attaining or has already attained LMIC status, are its policies more likely to be influenced by where it has come from (LIC) or where it is heading (MIC)?

Ghana is, in fact, in a peculiar position. Its government has been able to spend (temporarily) like some OECD countries (between 25 and 35 percent of GDP) due to large ODA flows—the portion channelled through the budget—and significant budget deficits, but its revenue collection places it just slightly above the average of LICs (or below, if the new GDP estimates are used). As such, it cannot support a permanent increase in the share of GDP it spends as is typical of a LIC as a means of achieving a 'developmental transformation'. Figure 10, which extends figure 3 onto the right hand side of the revenue scale up to a GDP per capita of $20,000, illustrates the point. It shows the well-known general positive relationship between development and the share of government expenditure—cross-sectionally in that case; it also includes a logarithmic trend line that suggests (but by no means assures) a possible 'path' along which a typical LIC might progress, starting at low level of GDP per capita. Clearly, Ghana stands out—with a few others.

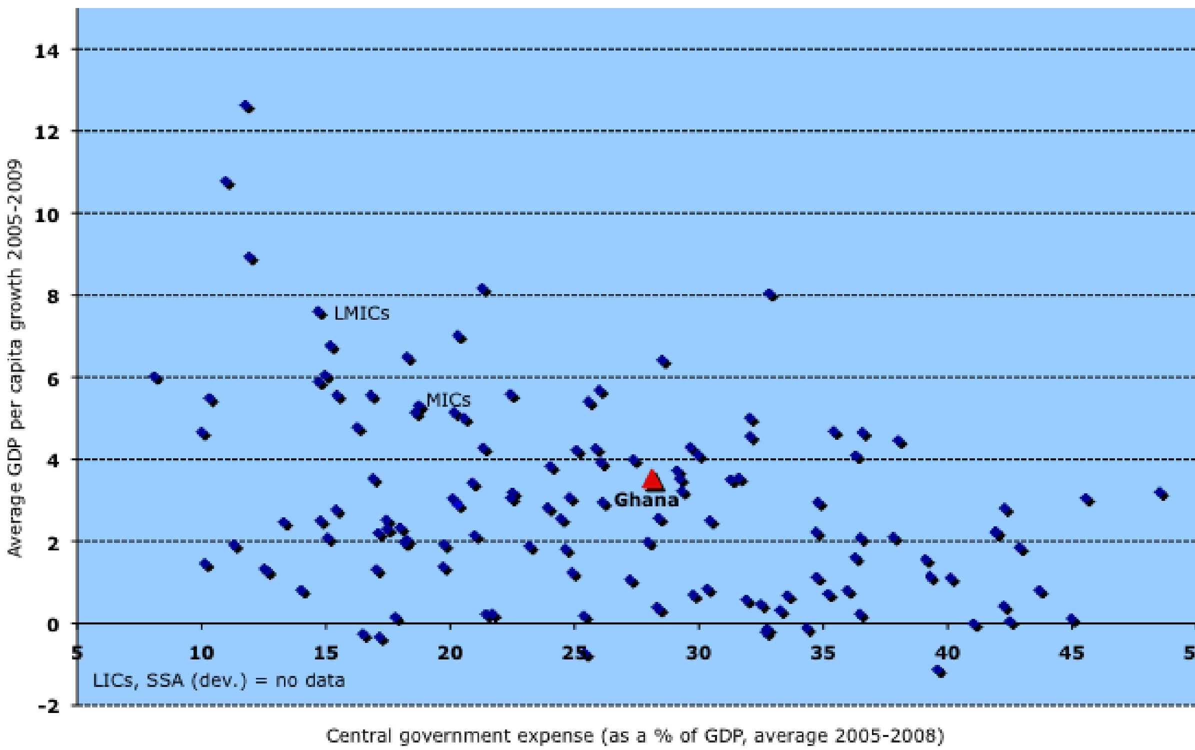
FIGURE 10: A SUGGESTED 'PATH' FOR CENTRAL GOVERNEMENT EXPENDITURE OVER GDP: GHANA AHEAD OF THE CURVE



Source: WDI, 2010

The chart shows that as a share of GDP, Ghana's government expenditure is on par with that of countries that are up to 20 times richer in per capita terms. This is not necessarily a problem as such. The main difficulty is that Ghana's economy appears to gain little benefit from such a high level of public spending, as illustrated in figure 11. It must also be noted that the overwhelming majority of countries located to the right of Ghana in figure 11 are already developed. We return to this crucial point after we examine in detail the pillars of fiscal space in Ghana. Table 2 also provides an overview of key indicators.

FIGURE 11 LIMITED VALUE FOR MONEY: GDP PER CAPITA GROWTH VS. GOVERNMENT EXPENDITURE



Source:WDI, 2010

TABLE 3 SELECTED MACROECONOMIC INDICATORS

Indicator	Year	Income levels				
		Ghana	LICs	MICs	LMICs	SSA
Per Capita GDP Growth (%)	2005-2008	4	4	6	8	3
	2008	5	4	5	6	3
Adjusted National Savings (percent of GNI)	2005-2008	9	14	21	31	8
	2008	-1		21	31	8
ODA per Capita	2005-2008	53	38	12	12	47
	2008	55	45	11	11	49
ODA (percent of GNI	2005-2008	9	9	0	1	5
	2008	8	9	0	0	4
Govt. Final consumption (% of GDP)	2005-2008	18	10	14	12	16
	2008	20	9	14	12	17

Source: WDI, 2010

4.2—Fiscal space in Ghana up to the 2015 MDG mark: what are the options?

Fiscal space provides a useful analytical framework and a tool for action to discuss the contribution of fiscal policy to the GoG's economic objectives. Practical analyses of fiscal space tend to focus on its 'pillars', or sources. Annex 1 presents the four main 'pillars' of fiscal space, as well as the analytical tool developed by the IMF (2006) and latter extended by UNDP (2007)—the 'fiscal space diamond'—that can be used to analyze the pillars systematically. The four 'pillars' (or sources) of fiscal space are: increased domestic revenue, additional borrowing (deficit financing), higher ODA and higher efficiency/reallocation of existing expenditures.[9]

By examining the four 'pillars of fiscal space' we identify the challenges and opportunities that Ghana confronts in mobilizing and efficiently using additional resources to accelerate progress towards the MDGs.

Development Assistance:

There is limited scope for an increase in ODA in the aftermath of the 2007-08 financial and economic crises and possible fiscal consolidations (including cut-backs) now underway in most donor countries. ODA is more likely to decline with Ghana having become a middle income, oil-producing country. There are no foreseeable circumstances in which ODA will increase significantly from current levels over the next five years. Nonetheless, the attainment of MIC status provides Ghana with increased access to other sources of non-concessional lending. During the recent CG meeting, the GoG requested higher levels of support and that the support be extended for another 5-10 years even after the attainment of MIC status. It remains unclear how DPs will respond. What would be useful is for the Government to pro-actively negotiate an aid exit strategy with the main donors. This strategy would explicitly recognizes that any retrenchment in aid will be highly sector specific affecting key social sectors (education and health) the hardest. Such an exit

[9] Compared to UNICEF (2009), which identified 6 pillars, we overlook seignorage as a significant source of fiscal space, especially in the Ghanaian context, and we treat debt relief as part of ODA. With inflation having averaged 20 percent for most of the past two decades, there is little scope for the GoG to capture seignorage. Indeed, it is more likely that the authorities issuing currency that substitutes for cedis (such as dollars and euros) will earn seignorage.

strategy could include provision for the higher levels of aid and the time extension requested at the CG meeting.

Domestic revenues:

As noted earlier, official figures show that approximately 22-23 percent of GDP is being raised as domestic revenue already. As also noted, this share (derived from non-rebased data) is relatively high. It does not change the fact that the level of domestic resources raised is inadequate to cover the Government's public expenditure commitments. As discussed in sections 1 and 2, GDP rebasing seems to place the current 'tax effort' below 15% of GDP. This would suggest that additional tax effort is possible over the medium term provided the GoG strengthens its tax administration. Part of the improvement in tax administration will require special public relations and tax enforcement and monitoring efforts (see below) to strengthen the 'culture' or habit of paying taxes.

The role of oil revenues needs to be addressed fully with government acknowledging that oil revenues alone will not remedy Ghana's budgetary challenges. The World Bank study (referred to earlier) has stressed the relatively limited stream of revenues that can be expected from oil and has highlighted the risks, economic and political, involved in allowing expectations of the "oil bounty" to get out of hand. Some observers have also noted that oil revenues are already being spent in advance (or pre-empted) through deficit financing and the expansion of public debt. Channelling part or all of the oil revenues into the budget with no change in policies will simply reinforce the factors that already distort the allocation of public expenditure (especially wage pressure). The least constructive outcome would be for Ghana to allow spending to adapt to revenue increases (the '*Please effect*'). There is little doubt that the responsible monitoring and use of potential oil revenues is fundamental to Ghana's growth and development performance. In this respect, the oil revenue management bill which apportions oil receipts to revenue, heritage and stabilization accounts is a highly positive initiative.

Deficit financing:

At one level, any consideration of additional deficit financing as a means of creating fiscal space is already moot due to the GoG's commitment to the IMF to reduce its budget deficit and eliminate arrears over the next three years. Indeed, this "fiscal consolidation" will reduce the fiscal space in the short term for all Government activities including the MDGs.

But, at a broader level, it would be prudent for the GoG to forego expanding the deficit even if there were no pressure from the IMF (and other DPs). Ghana's history of indebtedness, the current size of the budget deficit, and the arrears that remain to be cleared, provide no scope for further deficit financing over the short and medium terms.

Deficit financing is a key dimension of fiscal policy that serves some of its major objectives, including contra-cyclicality and growth. Nonetheless, deficit financing needs to be justified on the basis of a clear set of efficiency and equity criteria; the recognition of the limits imposed on future budgets (particularly debt service) by additional current expenditures; an explicit commitment to re-balance the budget during subsequent expansion cycles; and a full appreciation of the future risks involved of debt, inflation, and diminished growth. Any public investment program financed through additional borrowing needs to be consistent with the above requirements. Further requirements are a well-identified fiduciary and human development payback within a reasonable timeframe, backed by adequate structural reforms.

Moreover, officials who may believe that a "few more points" on the budget deficit would appropriately boost fiscal space in the Ghanaian context should be challenged to explain how the expansion of credit, increase in debt, rise in interest rates, increased real over-valuation of the exchange rate, and crowding out of the private sector would contribute to higher economic growth and improved welfare in the future. The preponderance of evidence from developing countries, including Ghana, which have a history of persistent budget deficits and chronic inflation (i.e., rates well above comparable world levels) is that these factors undermine rather than contribute to high, sustained rates of economic growth.

Efficiency:

All countries worldwide have room for greater "efficiency" in the use, allocation, and mobilization of public resources. However, some countries, including Ghana, have considerably more room than others. A number of priorities emerge which are related to the absence of a financial monitoring system that ensures consistency between the central and the local/district levels, an inadequate system of incentives for public servants in some key sectors (education in particular) and the rigidity in expenditures produced by earmarking. Since there is minimal flexibility in the other pillars of fiscal space, the main means of supporting the MDGs over the next five years will be the result of improved efficiency of public spending and public activities in general.

These observations are relatively uncontroversial. The challenge is ensuring that the Government acts accordingly. In several areas, the GoG has made a highly constructive start. It has a number of policies and mechanisms aimed at increasing efficiency of spending, such as the GIFMIS. The implementation of this System and the improvements in monitoring it implies is consistent with the increased demand for accountability that is both welcome and evident within Ghanaian society. The Government has responded in this area as well through its New Approach to Public Sector Reform, which is being supported by concurrent capacity development efforts. With the assistance of DPs, these initiatives are geared towards improving efficiency. An example is the Ministry of Finance and Economic Planning which is being restructured to enable it to better inform policy choices (and therefore expenditure choices) as well as to better monitor government programmes. Improved efficiency (through cost savings) is also being achieved by widely advertised Government efforts to remove 'ghost names' from its roll.

4.3—Considerations for fiscal space in Ghana moving forward

For the future, two main considerations emerge. The first is the question of sustainability and its determinants. The second is the challenge of the sequencing activities and interaction of the various pillars of fiscal space over time.

Savings, taxes, growth and sustainability

Within any particular year, the combined impact of ODA, borrowing, deficit spending, and improved efficiency can maintain the performance of current activities. But, with an expanding population and the increasing geographic/household/community coverage that is fundamental in making progress towards the MDG targets, the principal factor creating the fiscal space over time will be the capacity of the economy to grow. Indeed, it is only through economic growth that fiscal space can be expanded on a continual basis. This reality focuses attention on the purposes for which fiscal space is being created or leveraged.

One such purpose is to expand the share of the population which has met the MDG targets—the extremely poor, the malnourished, and the children out of primary school. A second purpose is to expand the stock of capital (physical equipment, infrastructure, trained workers, and knowledge) so that high rates of economic growth can be sustained. In this regard, a key difficulty in Ghana is its exceedingly low level of savings, at 5.4% in 1990 and 7.8% in 2006 (UNICEF, 2010). A further purpose is to expand the resources available to support recurrent expenditures (i.e., maintaining and operating the existing stock of capital) through adequate domestic resource mobilization and their efficient allocation. This requires creating a culture of paying taxes regardless of the specific purpose for which they are intended. This effort needs to be supported by improved monitoring of revenue and expenditures as part of a broader effort to increase transparency and accountability.

Fiscal space pillars in motion and over time

Meeting these objectives requires attention to different pillars of fiscal space at different points in time. Based on the fiscal space diamond, it is useful to think of systematic links among its four extremities. The fundamental objective of any development transformation is to increase the role of the extremities situated on the left and right on the horizontal axis (efficiency/reallocation and domestic revenues) relative to that of the bottom and top (ODA and borrowing, in which the government primarily relies on external funding). An agreed aid exit strategy mentioned above is an example of the link between the various pillars of fiscal space over time. Another is the need to consider explicitly and precisely the streams of maintenance costs when investing in physical capital, particularly when the principal source of investment is foreign aid or borrowing.

Section 5—Concluding remarks

The discussion in this paper has focused on options for leveraging the fiscal space to ensure the continued progress towards the MDG targets and to sustain human development beyond 2015. There are six recommendations.

5.1—Use oil revenues wisely—and creatively?

The discovery of oil is like taking a penalty kick in the final minute of the semi final of a big football tournament. It is an opportunity of which the greatest advantage should be taken. Ghana has an opportunity provided by a comparatively brief petroleum resource windfall. The challenge is to use that windfall to supplement existing resources in the most efficient, effective, and equitable ways possible. One option is to use the resources to expand investment thereby stimulating the rapid rate of growth required for Ghana to achieve and move beyond its MDG targets for 2015 in a sustainable manner. Another, which may be complementary, is direct cash distribution, of some or part of the revenues to the Ghanaian public. A recent paper (Moss and Young, 2009) suggests that such a proposal should not be dismissed outright. Indeed the direct cash distribution of oil receipts (especially if made contingent on shifts in behaviour) can directly contribute to MDG performance. Three key strengths of such a proposal are worth mentioning. First, direct cash transfers of oil receipts can increase annual household incomes by between US$80 - US$160 (based on whether 50% or 100% of the oil revenue is devoted to cash transfers and an average household size of 4 people). Second, such a policy can help reinforce the culture of inclusion and ultimately strengthen the idea that all Ghanaians benefit from and, in turn, need to contribute to development in practical ways. One of these is through voluntarily paying taxes. In essence, this option relates to creating the platform to sustain revenue generation in the future. Third, such a policy has the potential to significantly increase social engagement by creating the incentives for citizens to demand more accountability of Government actions.

5.2—Resist the temptation to earmark funds for the MDGs

Since the general goal of the present study is to examine ways of ensuring that MDG-related activities continue to be effectively implemented and efficiently funded, one obvious solution might be to earmark funding for MDG achievement. Doing that, however, would be counter-productive. First, as a practical matter, the current Ghanaian Chart of Accounts does not have the capacity to specifically identify MDG-related expenditures. This cannot be achieved until the GIFMIS is functional—which will take several years. Second, the GoG lacks a clear set of criteria for determining which revenues and activities should be earmarked. To earmark MDG-related expenditures to the extent possible would create additional confusion and rigidity in budget allocation. It would further undermine efforts to use the budget strategically for efficient macroeconomic management. Third, earmarking revenues for MDG-related expenditures would increase the bureaucratic and administrative load at a time when evidence already suggests that the Public Service has major problems with efficiency and effectiveness.

5.3—Leverage decentralization to improve efficiency and strategic allocation of public spending

There is room and a need for a marked and sustained improvement in the effectiveness of government operations and the efficiency of government services in Ghana. This will require setting priorities. With respect to the MDGs, an important change will be to take explicit measures to reverse the decline in education quality and to expand tertiary education enrolment so as to rebalance the education sector. A further improvement will involve concerted action by both the GoG and the DPs to reduce maternal mortality through the full implementation of MAF. Another priority should be to shift the relative shares of recurrent and investment spending in the budget. In general, decentralization provides a platform for implementing these kinds of reforms. In particular, it will be important to foster a demand for accountability at the local level by putting in place the means to measure and monitor the efficiency of service delivery. Achieving this will involve the more effective alignment of the procedures for accounting, allocation, and monitoring used by the MDA and the District Assemblies.

5.4—Focus on higher rates of economic growth

One dimension of the best-case scenario would be a rapid return of the economy to macroeconomic balance combined with accelerated policy reforms and effective implementation that substantially boosts the rate of economic growth. In the context of Ghana, "substantial" implies a jump from the recent growth rates averaging around 5 percent per annum (ISSER 2010, Table 1.1, page 12; IMF 2010, Table 1, page 20) to a rate that averages more than 7 percent per annum on a sustained basis. The need for this higher rate of growth was explained earlier. Ghana's population is projected to continue growing at around 2 percent per annum and all of the MDGs require that the activities and achievements with respect to poverty alleviation, food security, health, and education be extended to an increasing share of the population. In addition to the considerations and priorities mentioned in section 3.7, a basic foundation for this higher rate of growth will be the sustained expansion of agriculture at around its recent growth rate of 4 percent per annum. If that occurs, food security will improve, poverty will decline, regional imbalances will diminish (especially as infrastructure expands in the North of Ghana), and health status will improve (supported by improvements in nutrition and health delivery). Sustained growth in agriculture will support the expansion of agro-processing and transport and storage. These "rural growth linkages" will add impetus to the expansion of non-agricultural activities. In line with this growth objective it is important for the country to maintain fiscal discipline so that the fiscal recklessness which has characterised electoral cycles does not recur.

5.5—A continuation of the status quo should not be an option

The worst-case scenario will involve a continuation of current circumstances with delays in implementation of major reforms (regarding energy), the pre-emptive spending of the anticipated oil dividend (through continued large budget deficits), and allowing a major share of the budget to be absorbed by personal emoluments. A further dimension of the worst case scenario (and potentially the most damaging) is that, the prospect of significant resource gains from oil leads to the persistence of debt, deficits and a chronically over-valued real exchange rate. This potential outcome has already been examined in a recent study (World Bank 2010, Section D, pages 11-18). Under this scenario, economic growth in Ghana will be constrained and progress towards the MDGs will become progressively difficult, if not undermined.

5.6—DPs should scale back only gradually as part of an explicit, negotiated, aid exit strategy

Additional economic and social stresses would emerge if there were a rapid or unstructured disengagement by the DPs in response to Ghana's attainment of MIC status.

When and if the DPs scale back their support, two issues need to be openly acknowledged. First, the sectoral impact of donor disengagement will differ substantially. Decline in ODA will have little impact on oil, mining, and cocoa production. By contrast, the continued expansion of food production, the development of infrastructure in Northern regions, and progress in education and health are all highly dependent on donor support. Second, when it begins, donor disengagement needs to be phased in with significant additional transitional assistance to boost public sector capacities in technical, management and administrative skills.

To effectively address these matters, the DPs and the GoG should jointly (and collectively) negotiate an aid exit strategy. This will help rationalize the pattern and rate of disengagement. There are numerous examples of such strategies beginning with the reduction by the United States of aid to South Korea and Taiwan in the 1960s. Other examples are discussed in the literature (McPherson and Gray 2002, McPherson 2004).

None of the above options is out of reach. They simply require making the type of hard choices that Ghana needs to promote and sustain economic and human development.

*   *   *
*

References

AGRA (2010) "Summary of the African Green Revolution Parallel Sessions," African green revolution forum, Accra, September.

ISSER (2010) *The State of the Ghanaian Economy in 2009,* Institute of Statistical, Social and Economic Research, University of Ghana, Legon

Rep. of Ghana (2008) *Education Sector Performance Report 2008,* Republic of Ghana, Ministry of Education, Science and Sports, Accra

Rep. of Ghana (2010) Medium Term National Development Policy Framework, Ghana Shared Growth and Development Agenda GSGDA- I (2010-2013), Draft Technical Report, National Development Planning Commission (NDPC), Accra, July 2010

McPherson, M.F. and C.S. Gray (2002) "An 'Aid Exit' Strategy for African Countries: A Debate," Ch. 9 in (ed.) Malcolm F. McPherson *Restarting and Sustaining Growth and Development in Africa,* Bethdesda, MD: Franklin Printers for USAID

McPherson, M.F. (2004) "Ending Aid Dependence in Zambia, " Ch. 14 in (eds.) Catharine Hill and Malcolm McPherson, *Promoting and Sustaining Economic Reform in Zambia,* Cambridge MA: Harvard University Press for the John F. Kennedy School of Government.

Osei, R. D. and G. Domfe (2008) 'Oil Production in Ghana: Implications for Economic Development', Analysis of the Real Instituto Elcano, ARI 104/2008, Real Instituto Elcano, Madrid,

Vernon P, and D. Baksh "Working With the Grain to Change the Grain: Moving beyond the Millennium Development Goals," *International Alert,* 2010

UNDP (2010) *2008 Ghana Millennium Development Goals Report,* Accra: National Development Planning Commission (NDPC)/Government of Ghana and United Nations Development Programme

World Bank (1997) *World Development Report 1997 The State in a Changing World* New York: Oxford University Press for the Word Bank

World Bank (2009) *Ghana: Economy-Wide Impact of Oil Discovery in Ghana,* Report No.: 47321-GH, PREM 4, Africa Region, World Bank, Washington D.C.

Persons interviewed

Bank of Ghana

Stephen D. Amegashie, Chief Manager, Research Department

Kwaku A. Forkuo, Research Department

Ministry of Finance and Economic Planning

Samuel D. Arkhurst, Director of Budget

United Nations Development Programme

Ruby Sandhu-Rojon, Resident Representative

Kamil K. Kamaluludeen, Country Director

The World Bank

Sebastien C. Dessus, Lead Economist, Ghana

African Development Bank

Patrick C. Agboma, Principal Programme Officer, Ghana Country Office

African Development Fund

Eline Okudzeto

Environmental Protection Agency

Jonathan A. Allotey, Executive Director

Kwabena Badu-Yeboah, Deputy Director, Accra District Office

United States Agency for International Development

Pearl Coleman Ackrah, Private Sector Specialist, Economic Growth Office

UNICEF

Jane Mwangi, Monitoring and Evaluation Specialist

French Embassy

Arnaud Dornon, Head of Co-operation and Cultural Affairs

Appendix: The Fiscal Space diamond[10]

A useful operational device to explain what such an analytical framework would look like is the *fiscal space diamond*. This representation of fiscal space builds on the fiscal space diamond presented by the Development Committee (2006). The objective of the diamond is to address the questions that arise when policy makers wish to know: What are the macro fiscal possibilities to raise fiscal space to achieve intended policy goals? Such diagnostic of fiscal space needs to be highly country specific to have operational relevance.

The fiscal space diamond has four 'pillars' that collectively constitute the universe of avenues to secure fiscal space. The diamond is created by putting the four pillars together in Cartesian space, with the area of the diamond representing the aggregate fiscal space available in the country. The diamond does not include seignorage which is not commonly considered to be a desirable option. Governments can create fiscal space through the following types of fiscal instruments:

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

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

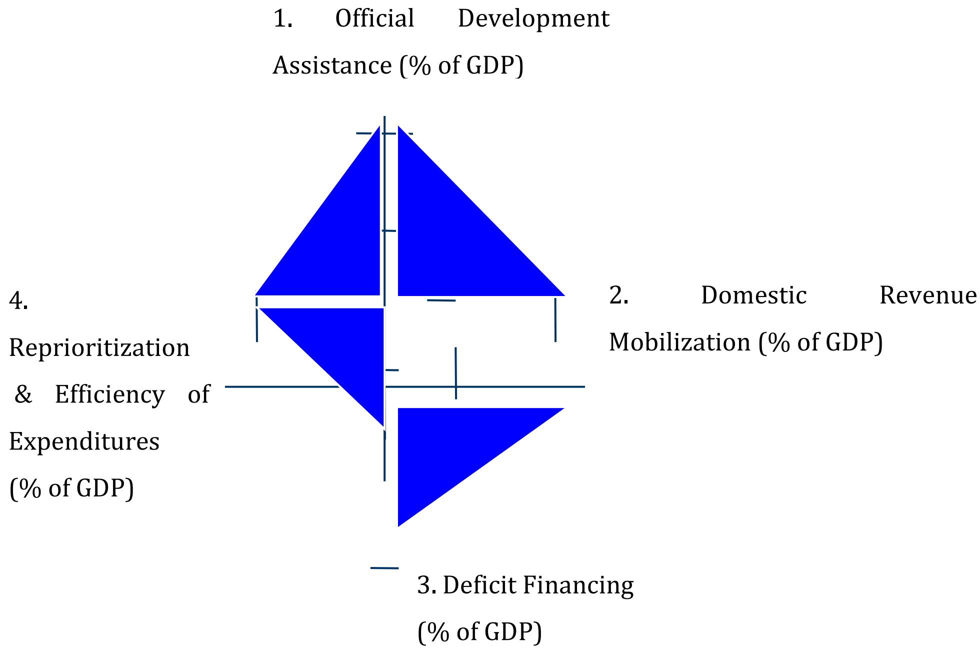
3) Deficit financing through domestic and external borrowing

4) Reprioritization and raising efficiency of expenditures

The diamond is constructed by (a) mapping the four pillars, one on each axis, with the total resources available under each head representing a point on the axis; (b) joining the points. It is of course possible to design different variations of this generic diamond. For example if one were to calculate the grant element of a concessional loan then that part of the loan could be put under the aid pillar with the balance under the loan pillar. The diamond can be constructed in incremental or absolute terms. There are many different situations in which the diamond can be used as an operational tool, depending on the policy assumptions. In the short run for example, expenditure switching policies and tax *policy* measures to increase revenue would be of limited value compared to measures that make public expenditures more Pareto-efficient (for example productivity gains) and tax *administration*

[10] From Roy, Heuty and Letouzé, 2006

reform measures. Conversely in the long-term the latter measures are unlikely to have as great a magnitudinal significance compared with the former.



It is therefore essential to define precisely the policy assumptions underlying the diamond, the time frame within which the different measures take effect and whether the policy actions that could be taken to tap into a source of fiscal space are endogenous or exogenous to *domestic* policy making.