



CENTRE FOR POLICY ANALYSIS

**THE CURRENT STATE OF THE
MACRO ECONOMY OF GHANA
2000-2009**

EXECUTIVE SUMMARY



Executive Summary

Introduction

The key economic issues that featured prominently in the national debates of the just-ended presidential and parliamentary elections of 2008 were the general state of the Ghanaian economy, promoting accelerated economic growth and job creation. The ultimate objective of the debates was the facilitation of a shared view to prosperity and poverty reduction.

Underlying these issues and national debates is the choice of two contrasting strategies for the development of Ghana's economy: accelerated economic growth with macroeconomic stability, on the one hand; and macroeconomic stability with economic growth, on the other hand.

Central to resolving the above issues, is the budget deficit and its financing. CEPA's earlier assessment of the state of Ghana's macro-economy in its Ghana Economic Review and Outlook: Part I, Focusing on Fiscal Performance, which was published in May 2008, drew attention to: "a stubbornly high and widening deficit" (page 42). The key challenge that the new President is confronted with is how to tackle this deficit problem within the context of the national medium-term goal of sustained and accelerated growth with macroeconomic stability.

Moreover, solutions must be sought in the context of the current global financial crisis (dubbed the "credit crunch" or "financial protectionism"), and the downgrading of Ghana's sovereign ratings, both of which make foreign direct investment (FDI) as well as external borrowing from international capital markets, even on commercial terms, more difficult to obtain.

Background

Following the successful completion of a two-term presidential rule — first time in post-Independence Ghana — and the peaceful hand-over of the reins of government across the political divide in 2001, the nation received what has been described as a "handsome democracy dividend". In spite of this, or, perhaps because of it, fiscal excesses in the early years of the new Administration led to the failure and abandonment at the end of September 2002, of the three-year economic programme of 1999-2002 agreed with the International Monetary Fund (IMF)

under its Poverty Reduction and Growth Facility (PRGF). This debacle was largely on account of:

- higher-than-budgeted for public sector wage bill; and
- subsidies to the petroleum, water, and the electricity sub-sectors.

A successor programme agreed with the IMF for the period 2003 to 2005 required the removal of the petroleum price subsidies as conditionality. A policy of import parity pricing, meaning a full pass through of changes in the cedi value of world market prices of petroleum and petroleum products to domestic consumers was instituted. A mechanism to give effect to this policy was also put in place. Consistent with the poverty reduction objective, the mechanism included cross-subsidization of products of importance in the consumption baskets of the poor — such as kerosene.

Given the high social and political costs involved, however, the policy was not consistently implemented. Subsequent continued increases in international prices of petroleum and petroleum products were not fully passed through to domestic consumers. The Government of Ghana, apparently, could not countenance any such domestic price increases since (as was communicated to the IMF and the development partners) in its view, this could be politically “destabilizing”. In January 2005, with the 2004 elections out of the way, petroleum product prices were increased, on average, by 50 percent.

Thereafter, the policy of full pass through of price changes in the world market, once more, was not consistently implemented resulting in significant losses and debt at Tema Oil Refinery (TOR) currently estimated at GH¢1.4 billion (Business & Financial Times (B&FT), January 28, 2009, page 15).

These experiences in the oil sector, concerned with subsidies, fiscal discipline and macroeconomic stability, serve to illustrate the futility and unsustainability of pursuing the strategy of macroeconomic stability with growth. They also show the possible high cost of procrastination in responding to shocks whose consequences linger on — in other words, better considered as permanent rather than temporary shocks. A good rule in economic policy

management is that permanent shocks call for policy adjustment; temporary adverse shocks are best financed. Delayed responses to a persistent or permanent shock could accentuate costs which could be destabilizing.

Budgetary Performance

Over the period from 2005 to 2008, the budget has performed continually much worse than planned. The overall broad balance has registered deficits which have widened from about 3 percent of national income¹ in 2005 to 7.8 percent of national income in the following year, 2006 — far above its target in the budget and over two and a half times the previous outcome. This latter outcome, termed a “fiscal surprise” by the rating agency, Fitch, was cited as the reason for its downgrading of Ghana’s sovereign rating in year 2007.

The primary reason for the deteriorating fiscal performance over the last four years has been the rapid growth of expenditure. In each of these years, expenditure has risen faster than national income and overshot the budgetary provision by considerable margins. Thus, from a share of 26 percent of national income in 2005, the share of domestic expenditure in national income (i.e. excluding foreign-financed expenditure) rose to 30.1 percent in 2006, and then to an estimated 30.7 percent in 2007; and for 2008, CEPA estimates point to a share of at least 38 percent of national income.

In contrast, the share of domestic revenue² in national income was relatively stable at about 18 percent of national income over the three-year period from 2000 to 2002; it improved substantially since then to 23.8 percent of national income in 2005 but declined to 22.5 percent of national income in 2007; it is however forecast to rise to 25.1 percent of national income in 2008 on the back of the “Talk Tax”. Overall, domestic revenue has risen faster than national income and also risen more mildly than domestic expenditure. The differences in the pace of these increases underlie the widening budget deficits. The evidence thus strongly suggests that the revenue mobilization effort has been quite successful, with revenue rising, at the minimum, apace with national income.

¹ National income is used in this document to be synonymous to gross domestic product (GDP) as measured by the Ghana Statistical Service.

² This comprises tax and non-tax revenues; the non-tax element excludes the portions retained by the collecting agencies.

Public Sector Debt

The debt relief and debt cancellation provided by the IMF, World Bank and bilateral donors under the Enhanced HIPC Initiative and Multilateral Debt Relief Initiative (MDRI) helped reduce Ghana's debt stock from 198.3 percent of national income in 2000 to 118.8 percent of national income at end-December 2003, and further down to a trough of 41.9 percent of national income at the end of 2005. Since then it has turned on an upward path reaching 49.8 percent of national income at the end of 2007 and an estimated 52 percent of national income at the end of 2008.

According to the Bretton Woods Institutions — the IMF and the World Bank — about 60 percent of this new debt has been contracted on commercial terms from international capital markets, export credit agencies, and local-currency denominated government bonds. In particular, in September 2007, the Government of Ghana placed US\$750 million in Eurobonds with a coupon of 8.5 percent at 10-year maturity. This will imply annual interest payments of about US\$64 million. The remaining part of the new external public debt has been contracted on concessional terms with multilateral institutions and bilateral official creditors (see Ghana: Joint IMF and World Bank Debt Sustainability Analysis, June 16, 2008 paragraph 2 page 3).

The point of considerable concern that arises from the above analysis of a rising public debt is the disturbing picture Ghana is presenting of a HIPC that is following a path back to high indebtedness soon after having the bulk of its original debt cancelled. Paul Rawkins of the Fitch Rating Agency is quoted by the Business & Financial Times (B&FT) of February 2nd, 2009 on this subject as follows: "if it keeps going this way, they will lose all the benefits they got from debt relief. If it got towards 70 percent, that would certainly be bad news.....that would certainly be negative for credit rating".

Public Sector Wage Bill

The public sector wage bill has been an important contributory source of budgetary excesses. And yet, inability to control it has also been a perennial problem over the past eight years. Moreover, CEPA has regularly drawn attention to this perennial problem in its reviews of the state of the economy. The official reasons given for this phenomenon, however, have varied. The

common strand in the various explanations given for wage bill overruns is summarized in the foreword of the 2007 Budget Statement:

There are problems at the labour front resulting partly from a distorted public sector salary structure which is also poorly administered. Government has, therefore decided to begin the implementation of a new comprehensive public sector pay reform that emphasizes equal pay for work of equal worth. The broad objective is to aim for wage increases in line with productivity gains, cost effectiveness and efficiency.....To ensure order and equity all round, government is setting up a Fair Wages and Salaries Commission to oversee the implementation of this new programme.....The public sector reforms that are being pursued will be sustained to boost private sector development through an enhanced public services delivery in order to deepen public-private sector partnerships for accelerated growth (2007 Budget Statement, pages 5 and 6 — emphasis added).

The Fund Staff has urged that: Civil Service reform needs to resume in earnest, with the medium-term goals of attracting high quality labour and reducing total public sector employment. In pursuit of the above, the Fund staff recommended that: temporarily freezing hiring in the public sector (beyond the automatic absorption of trainees in health and education) is required in order to keep the wage bill within the 2008 budget. They go on to suggest that the freeze should last until Civil Service reforms regain momentum (possibly after the elections).

CEPA agrees with the views expressed in the foreword of the 2007 Budget Statement, namely:

- To aim for wage increases in line with productivity gains, cost effectiveness and efficiency;
- To ensure order and equity all round, government is setting up a Fair Wages and Salaries commission to oversee the implementation of this new programme; and
- To boost private sector development through an enhanced public services delivery in order to deepen public-private sector partnerships for accelerated growth.

Certainly, in the key sectors of health and education a lot needs to be done about remuneration to attract and retain the professionals at home. Their skills are needed for the development of the healthy and skilled human resource necessary for the preferred path of accelerated growth with macroeconomic stability. Moreover, their absence or insufficient presence could mean an intensification of socio-political instability which could flow out of poor service delivery in the key social sectors.

The freezing of public sector hiring ahead of a buoyant and booming private sector able to create the much-needed jobs on considerations of the requirements of short-run macroeconomic stability is not a viable option and is simply unacceptable; so also any attempt to freeze the wage rates. It must be stressed that socio-political stability is a necessary condition for sustainable macroeconomic stability.

Growth and an accelerated one as such, in our context, must be the national priority. The differences between the CEPA position and the IMF stem from the contrasting visions of Growth with Macroeconomic Stability as against Macroeconomic Stability with Growth. Not surprisingly, while the Government of Ghana and Ghanaians aspire to the Asian type growth rates in the range of 7 to 9 percent per annum, most IMF medium-term growth projections for Ghana are, at best, in the range of 5 to 6.5 percent per annum.

Monetary Policy and Inflation

Ghana has often experienced high rates of inflation — the recent ones being in 1999-2000 and 2002-2003. These have been caused by a combination of external shocks, unsustainable macroeconomic policies and exchange rate depreciation. Alas, all of these are present in the current situation witnessed since the fourth quarter of 2007. Indeed, other than the year 2005, controlling money supply growth has been problematic — in both the monetary base control period of 2000 and 2004 and the latter period of inflation targeting of 2006 to 2008.

Notwithstanding the difficulties of controlling the money supply growth, the performance record in respect of inflation and inflation expectations have been commendable. As noted elsewhere, Ghana is vulnerable to severe supply shocks from weather and commodity price developments. Abstracting from these adverse exogenous factors, the record of inflation performance in the period from January 2002 to the last quarter of 2007 (averaging 13.5 percent per annum) can indeed be described as reasonably satisfactory — just outside the recommended range of 8 to 13 percent per annum for Ghana at this time.

The unpalatable fact is that disinflation requires that a “negative output gap”, sooner or later, opens up. A negative output gap implies a reduction of aggregate demand below the productive

potential of the economy. In other words current output and spending are brought below what the economy could sustain, leading to spare capacity. This output gap — output and employment lost to the economy — is a measure of the short-run sacrifice required for disinflation. Moreover, for any given economy, the evidence suggests that there is a context-specific range of inflation rates — currently estimated to be between 8 percent and 12 percent for Ghana — below which the sacrifice becomes exorbitantly high. For a developing country with widespread and deep poverty, keeping the ratio to the barest minimum is of outmost importance.

In our circumstances, aiming to keep output at its potential level has an obvious justification since this is a fundamental objective of the accelerated growth with macroeconomic stability strategy. Output and job losses could have particularly grave socio-political consequences in an economy already facing rising joblessness, high levels of underemployment and open unemployment. Moreover, in the current international environment where a high country risk premium may be charged on Ghana Government debt instruments, hiking the interest rate could turn out to be counterproductive — an exercise in futility — as it may fail to induce the expected net capital inflows.

International Trade

The experience over the past years reveals once again the vulnerability and fragility of a primary commodity-dependent economy which, moreover, is losing non-traditional export market shares in international markets. This worrisome situation appears to be the result of a combination of an overvalued currency (which may be squeezing profit margins of exporters and import-competing enterprises) and an inadequate incentive scheme that together render products made in Ghana uncompetitive at home and abroad.

With regards to traditional export commodities, gold export earnings led the way and as a result its share in overall export earnings in 2007 represented 43 percent of the total. Indeed, since 2004, the share of gold export receipts in overall export earnings exceeded those of all other export commodities, thus making gold the dominant export commodity. Gold exports increased by almost 36 percent in value terms in 2007. This was both on account of record-high prices on world markets and increased export volumes. While export volumes increased by 19 percent

above the average for the preceding year, world market prices rallied by more than 15 percent above the average registered in 2006. An issue of some concern is that while the gold sector has witnessed considerable boom in recent times, its contribution to the country's international reserves and budgetary revenue has been minimal.

In comparison, export earnings from the shipment of cocoa beans and products fell by 7.1 percent in 2007 relative to 2006. The decline in earnings was largely due to a sharp fall in the volume of cocoa beans shipments even in the face of continuous price rallies on world markets. Thus, the average price increased by about 23 percent while the volume shipped declined by 14.8 percent in 2007.

Foreign exchange earnings from the group of export items dubbed non-traditional exports (NTEs) — defined here to exclude cocoa and wood products — have performed rather poorly. Over the past four years, the contribution of NTEs to overall export earnings has been falling, with an apparent dwindling in shares of the horticultural category of agricultural goods. The evidence suggests that over the past four years, export volumes of pineapples — which used to be the highest earner in the horticultural category of agricultural NTEs — slumped by 66 percent on account of an unexpected shift in demand from the smooth cayenne variety preferred by Ghanaian farmers to the so-called MD2 variety mostly produced in South America.

Some Lessons from East Asia and China

Lessons from the experiences of the East Asian Tigers and lately China and India, have shown that increased emphasis on higher education — highlighting science and engineering courses and vocational and entrepreneurial training and skills development — as well as massive investments in research and development that is oriented towards the creation of new products and product designs, marketing methods and organizational forms, can be important in bringing about the dynamism required for intensifying competition between enterprises and between countries. Knowledge and information have become the key drivers of international competitiveness, making it crucial to respond rapidly and efficiently to evolving technological changes.

It is about time Ghana's export diversification drive was charted along these lines. A first step would be to address the myriad institutional and infrastructural bottlenecks that seem to be holding back efficient service delivery in the non-traded goods sector — namely, improving the legal and institutional environment for doing business in Ghana, and minimizing the bureaucratic processes of service delivery in financial and public sector institutions, including deposit money banks, public utility agencies, as well as the MDAs.

Way Forward

Given the national long-term goal of **Growth with Macroeconomic Stability**, the key challenges over the medium-term are the following:

- Priority needs to be given to the near-term policy challenges of pulling back from the current expansionary fiscal policies. Limiting the fiscal deficit would also make more room for private sector development through “crowding in” of the sector. In any case, fiscal policy must carry the brunt of the needed adjustment. Public financial management (PFM) reforms have continued but recent and on-going fiscal slippages have exposed recurring weaknesses which must be rectified.
- CEPA supports the proposed enactment of the Fiscal Responsibility Law (FRL) — improving fiscal discipline and anchoring fiscal expectations. Even though we regard it as a necessary condition, it is by no means sufficient. CEPA has noted that “The passage into law of a Fiscal Responsibility Law (FRL) by itself is not sufficient to promote fiscal discipline” Ghana Economic Review and Outlook, Part 1: Focusing on Fiscal Performance, page 32, Box 1). At the same time there is evidence it could help. The PRGF programme agreed with the IMF for the period 2003 to 2005 (this had to be extended to October 2006) contained an explicit medium term conditionality namely: *The end 2002 domestic debt to GDP ratio shall be halved by end 2005*. Adherence to this, even if with difficulty, certainly contributed to the macro-economic stability achieved over the period. The FRL, when it comes into being, could play this role in any future programme.

- Further re-orienting fiscal priorities towards development — in terms of government expenditure, tax policy that leaves more resources in the hands of workers, entrepreneurs and investors (making it profitable to work and invest in Ghana), improved public service delivery, eliminating wasteful expenditure and insisting on value for money; and
- A sharper focus on the enhancement of productivity through technical and vocational training skills development particularly management, increased use of knowledge and improved technology in production, and efficient investment in infrastructure especially in transportation and energy.

The flight of private capital means emerging and developing economies with current account deficits face a drought of both financing and export earnings, particularly from non-traditional exports (NTEs). Likely developments in respect of world market prices of gold and cocoa on the one hand, and the low and declining price of oil on the other hand, suggest a possible positive outcome for Ghana's commodity terms of trade — a comparative measure of prices on imports and exports.

The perennial problem of subsidies, however, is likely to remain even if with a twist to it. The difference is that instead of subsidies for the imports of petroleum products, electricity and water sub-sectors, the problem in the near term will be how to fund and channel the subsidies to prop up the NTEs and possibly even cocoa (being a commodity) in the event that world market prices fall too low to sustain profitable production and cocoa producer price.