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Ghana's 2015-17 IMF Program:

A Review by the Institute for Fiscal Studies

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The views expressed in this paper are the views of the IFS

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Executive Summary

Ghana's medium-term development prospects have been put at risk after two decades of strong and broadly inclusive growth, due to large fiscal and external imbalances in recent years which have led to a slowdown of economic growth. To address these imbalances and safeguard the bright medium term prospects of the economy, the government embarked on its homegrown economic and financial program, but policy slippages, exogenous shocks, rising interest costs, and acute power shortages undermined the effort. With no option left, the government approached the IMF for a medium term program to enable the country obtain some balance of payments support and policy credibility that the Fund's program usually brings to the market and investors.

After protracted negotiations, a three-year IMF program with US$918 million financial support was agreed to help restore debt sustainability and macroeconomic stability, and together foster a return to high growth and job creation, while protecting social spending. The program calls for a strong front-loaded fiscal adjustment to contain public expenditure and mobilize additional revenues, and structural reforms to strengthen public finances and fiscal discipline. It also called for a strengthening of monetary policy and elimination of its fiscal dominance as well as preserving the financial sector stability. To alleviate the potential adverse impact of the strong fiscal adjustment on the most vulnerable in the society and protect real income of the poor, commitment has been made by the government to use part of the resulting fiscal space to safeguard social and other priority spending. The envisaged fiscal consolidation is projected to dampen economic growth further and reduce inflation initially, but growth is expected to rebound after 2015. On the fiscal side, the program aims at turning the primary balance from a deficit to a surplus in 2015 and over the medium term. It also aims to reduce the overall fiscal deficit down to 3.7 percent in 2017.

This review of the Fund program by the IFS has established that although the program may ease short-term fiscal and financing pressures in the economy, the medium term outlook is still subject to considerable risks which have not been adequately addressed in the design of the program. The projected slowdown of the economy to 3.5 percent in 2015 under the program will be the lowest in more than two decades, making the expected strong rebound over the medium term too optimistic. Unless the macroeconomic environment improves significantly, the additional oil and gas come on stream, and cost-effective solutions to address the energy crisis are found, the growth targets in the medium term will be difficult to achieve. The fiscal deficit targets under the program are also too ambitious given the structural weaknesses, poor management of the country's public finance, and the slowdown of economic growth. We also find the reduction of the central bank's financing of government to zero over the medium term to be unrealistic and could have negative growth implications. The program therefore needs to be re-examined, with the view to adjusting the fiscal and growth targets to more realistic levels. There is also the need to front-load the financial support to complement the front-loaded fiscal consolidation.

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1. Introduction

After two decades of strong and broadly inclusive economic growth which enabled Ghana to reach middle income status and also helped the country to make significant progress towards the attainment of the Millennium Development Goals (MDGs), the country's economic performance has weakened recently, compounded by the sharp drop in oil and commodity prices and power shortages. Growth has decelerated, the fiscal and current account deficits have widened significantly, leading to a rapid depreciation of the local currency, re-emergence of high inflation, and rising public debt. Government's efforts to achieve fiscal consolidation since mid-2013 were undermined by policy slippages, external shocks and rising interest cost. Until mid-2014, the country's net international reserves position had further weakened and the cedi exchange rate depreciated sharply, fueling inflationary pressures (IMF, April 2015). To deal with these challenges, the government approached the IMF for a three-year Extended Credit Facility (ECF) arrangement for the period 2015-17 to support a stronger policy adjustment and reform program to restore macroeconomic stability and debt sustainability, and also foster market confidence to help achieve the country's transformation objectives.

The purpose of this paper is to review the IMF program, which is planned to run between 2015 and 2017, with the view to establishing whether the program can help deal with the challenges currently confronting the country and those envisaged over the medium term. The paper is organized as follows. Section two provides a brief discussion of the recent economic developments to provide a context to the Fund-supported program. Section three provides details of the Fund program, focusing on the program objectives, policies, prior actions, quantitative targets and structural benchmarks. The section also discusses the perceived risks to the program. Section four discusses our comments on the program while section five provides some recommendations to enrich the program. Section six concludes the study.

2. Recent Economic Developments

Real GDP growth stood at 7.3 percent in 2013 from 9.3 percent recorded in 2012. The 2013 growth was supported by the services sector which recorded the highest growth of 10.0 percent, followed by industry with 6.6 percent growth, and agriculture with 5.7 percent. The slowdown in growth in 2013 was due to a combination of unsustainable domestic imbalances, including rising interest rates and depreciation of the cedi, and unfavorable global factors, mainly the decline in gold production due partly to the drop in world prices (GoG, March 2015). Economic growth decelerated markedly in 2014, driven by a sharp contraction in the industrial and services sectors. Real GDP growth dropped to 4.0 percent in 2014, with the services sector recording a real growth of 5.7 percent, industry, 0.9 percent and agriculture 4.6 percent. The slowdown of the industrial and services real output was due to the negative impact of the cedi depreciation on input costs, increasing and high interest rates on public debt, declining domestic demand and increasing power outages.

The fiscal deficit has remained high in the last three years. The year 2012 ended with a fiscal deficit of 11.6 percent of GDP on account of a number of factors. These include the clearing of arrears (road arrears, wage arrears associated with the single spine wage policy initiated in 2009, liabilities of some state-owned enterprises, etc.); significant shortfall in grants from donors; over-estimation of revenues from oil companies; larger than expected petroleum and utility subsidies; and higher interest cost burden arising from the rise in short term domestic interest rates and about GH₵1.0 billion recorded in the 2012 budget as a discrepancy. The fiscal deficit dropped to 10.4 percent of GDP in 2013, despite the number of revenue and expenditure measures introduced in the year. Adverse developments in the global commodity prices and overruns in the wage bill, energy subsidies, and rising interest costs made it impossible for the fiscal deficit target of 9.0 percent for the year to be achieved (GoG, March 2015).

The high fiscal deficit continued in 2014 despite the modest fiscal consolidation efforts undertaken since mid-2013. These efforts continued to be undermined by policy slippages, increasing debt-service and external shocks. Despite higher oil revenue, improved tax collection and some containment of the wage bill, delays in implementing some adjustment measures and unbudgeted wage allowances resulted in a higher-than-budgeted cash fiscal deficit of 9.4 percent of GDP. Additional domestic arrears were accumulated and the overall fiscal deficit on a commitment basis remained close to 10 percent of GDP. In addition, the government started facing financing difficulties which led it to resort increasingly to short-term domestic debt, which now carries interest rates at around 25-26 percent, and significant monetary financing. A US$1 billion Eurobond was successfully issued in September 2014, but at a significantly higher interest rate than other issuers in sub-Saharan Africa due to the high risks associated with the country's fiscal imbalances (IMF, April 2015). Cote D'Ivoire, Ethiopia, Kenya, Rwanda, and Nigeria, for example, all have issued Eurobonds recently at an average coupon rate of 6.0 percent, compared to Ghana's rate of 8.1 percent.

Despite the difficult conditions, the country continued to pursue its inclusive growth agenda with improved social spending in critical sectors. In 2013, the authorities achieved the MDG on reducing extreme poverty, which declined from 16.5 percent in 2005/06 to 8.4 percent in 2012/13, while overall poverty was also significantly reduced. Success was also achieved in improving access to education alongside reducing gender disparity in primary education and increasing the provision of water resources to the poor. While the country outperformed its regional peers in reducing poverty and improving social indicators, the government agrees that further efforts are needed in areas such as reducing maternal and child mortality rates and increasing access to improved sanitation (IMF, April 2015).

Table 1: Ghana: Selected Economic and Financial Indicators, 2012-2014

Indicator	2012	2013	2014
Real GDP growth (%)	9.3	7.3	4.0
Real GDP growth (non-oil; %)	8.6	6.7	4.1
Inflation (end period; %)	8.8	13.5	17.0
Broad money (M2+; % change)	24.3	19.1	36.8
Revenue (% of GDP)[a]	18.5	16.5	18.4
Expenditure (% of GDP)[a]	30.1	26.8	27.8
Overall balance (cash; % of GDP)	-11.6	-10.4	-9.4
Net domestic financing (% of GDP)	9.2	7.0	4.4
Current account balance (% of GDP)	-11.7	-11.7	-9.2
Gross international reserves (US$m)[b]	5,348	4,587	4,349
Total public debt (GH₵b)	35.1	51.9	76.1
As % of GDP	48.4	55.3	67.1

Source: BoG (Feb. 2015); GSS (Jan. 2015); IMF (April, 2015); a: excludes tax exemptions, internally generated funds, and tax refunds; b: excludes petroleum funds and encumbered assets.

Inflation which stood at 10.1 percent in January 2013, reached 13.5 percent in December of the same year on account of the removal of subsidies on petroleum products and utility tariffs, the pass-through effects of exchange rate depreciation, and the impact of the large fiscal deficit. Headline inflation peaked at 17 percent in November 2014, well above the 8±2 percent target range despite the several hikes in the Bank of Ghana (BoG) policy rate which reached 21 percent in October 2014. Inflation pressures in 2014 were driven by the large depreciation of the cedi, the financing of the deficit by the Central Bank, and the effects of the petroleum product price increases. Inflation stood at 16.6 percent in March 2015 from 16.5 percent the previous month, pushing the inflation rate further away from the government's end-year target of 12 percent.

Ghana's public debt situation also worsened in recent years and the country now faces a high risk of debt distress and increased overall debt vulnerability. Total public debt rose to GH₵76.1 billion in 2014 (equivalent to 67.1 percent of GDP) from GH₵35.1 billion in 2012 (equivalent to 48.4 percent of GDP). By March 2015, the total public debt stock had reached GH₵88.2 billion, representing 65.3 percent of GDP, implying that the total public debt increased by GH₵53.1 billion or 151 percent between December 2012 and March 2015 (BoG, May 2015; Feb. 2015). Total public debt service-to-revenue ratio (including payments on external and domestic debt) is also not only on a rapidly increasing path but has breached its indicative long term threshold. Debt service absorbs a large part of domestic revenue, leaving the country vulnerable to shocks. All other debt indicators have deteriorated owing to the worsening domestic and external borrowing conditions, weak fiscal consolidation, and weakening of the cedi.

The performance of the external sector was equally weak during the review period due to the volatility in prices of the country's main export commodities, especially gold and cocoa. Large net service and income outflows and the slowdown in official and private transfers resulted in a deterioration of the current account deficit which stood at 11.7 percent of GDP in both 2012 and 2013 (see Table 1). This deficit was offset mainly by foreign direct investments and portfolio flows (GoG, March 2015). The weakness of the external position continued through 2014, with the current account deficit remaining very high and the net international reserves reaching low levels in the third quarter and the exchange rate depreciating sharply. During the first half of the year, difficulties of the government to roll-over bonds held by nonresidents and the clearing of large outstanding letters of credit for oil imports resulted in large capital outflows. New regulations on current and capital transactions adopted by the BoG in early 2014 to stem the outflows had limited effect and were largely reversed in July, although a few exchange restrictions remained. As a result, the exchange rate dropped sharply in the first 8 months of the year before recovering on the back of inflows from the September Eurobond and the US$1.7 billion short-term loan contracted by the Cocoa Board. For the whole of 2014, the cedi exchange rate dropped by 31.2 percent, making it the worst performing currency in the world (BoG, Feb. 2015). The currency depreciation and the economic slowdown led to a substantial contraction of imports and a narrowing in the current account deficit, which nonetheless ended at 9.2 percent of GDP in 2014 (see Table 1).

The financial soundness indicators suggest that the country's financial sector was relatively robust, but vulnerabilities stemming from weakening growth were high. Resilience to shocks by individual banks appeared weaker while credit risk emanating from the slower economic growth increased. The high cedi interest rates imply that many projects were inherently high risk. Lending in foreign currencies to unhedged borrowers exposed banks to credit risks in the face of the cedi depreciation and potential foreign exchange liquidity risks given the shallow foreign exchange market (IMF, April 2015).

Recognizing the need to tackle the fiscal challenges and to restore macroeconomic balance, the government formulated a home-grown stabilization and reform program, anchored on the second Ghana Shared Growth and Development Agenda (GSGDA II, 2014-2017) in early 2014. Despite some progress, implementation of this program was hindered by intensification of external shocks, including disruptions

to gas supply and fall in commodity prices, increased debt service costs, and inadequate policy response. The situation temporarily stabilized on the back of the Eurobond issued in September 2014 and a short-term loan contracted by the Cocoa Board, but public debt continued to rise at an unsustainable pace and the cedi depreciation resumed, requiring a strengthening of the adjustment process. With no option left, the government approached the IMF for a medium term program to enable the country obtain some balance of payments support as well as the policy credibility that the Fund program brings to the markets and investors.

3. The IMF Program

On Friday, April 3, 2015, the Executive Board of the International Monetary Fund (IMF) approved a three-year arrangement under the Extended Credit Facility (ECF) for Ghana in an amount equivalent to SDR 664.20 million (180 percent of quota or about US$918 million) with zero percent interest rate and a repayment period of 10 years to support the governments' medium-term economic reform program. The Executive Board's decision enabled a disbursement of SDR 83.025 million (about US$114.8 million) to take place on April 14, 2015.

The program aims at a sizeable and frontloaded fiscal adjustment to restore debt sustainability, rebuild external buffers to increase resilience to shocks, and enhance the effectiveness of monetary policy by limiting fiscal dominance. The envisaged consolidation is to be driven by enhanced revenue mobilization, improvement in public financial management, and cuts in low-priority public spending, while rebalancing expenditure in favor of infrastructure investments. The elimination of fiscal dominance of monetary policy is expected to help restore the effectiveness of the BoG's inflation targeting framework (IMF, April 2015).

The planned fiscal consolidation is expected to dampen non-oil economic growth initially and reduce inflation in 2015. Growth is however projected to pick-up in 2016, supported by expected increases in crude oil production while lower inflation and interest rates, combined with a stable exchange rate environment will help support private sector activity. Real GDP growth is projected to drop to 3.5 percent in 2015 before picking up to 6.4 percent in 2016 and 9.2 percent in 2017. Non-oil GDP growth would decelerate further to 2.3 percent in 2015 before picking up thereafter, reaching 5.5 percent by 2017 (Table 2).

The commencement of gas production in 2015 is expected to lower electricity generation costs and reduce oil imports. The increase in oil exports and compressed aggregate demand will support an improvement in the external current account deficit over the medium term, from about 9 percent of GDP in 2014 to about 5 percent in 2017. The projected surpluses in the financial and capital account balances stemming from projected private flows and identified donor financing, together with IMF support would help build up gross reserves to a more comfortable level of 4.2 months of imports of goods and services by 2017, while allowing a gradual unwinding of BoG's short-term liabilities (IMF, April 2015).

3.1. Fiscal policy

During the program period, the fiscal position is to be substantially strengthened to achieve debt sustainability. The program seeks to enhance revenue collection, restrain the wage bill and other recurrent expenditures, while making space for priority spending and the clearing of all domestic arrears. Despite the lower than previously projected oil revenues over the program period, the primary fiscal balance (on a commitment basis) is envisaged to turn from a deficit of 3.5 percent in 2014 to a surplus of 0.9 percent of GDP in 2015 and then to 3.2 percent of GDP in 2017 (Table 2). Reflecting increasing interest payments in 2015 and planned repayments of arrears, the overall cash deficit would decline more gradually from 9.4 percent of GDP in 2014 to 7.5 percent in 2015 and to 3.7 percent in 2017. Despite the

fall in the fiscal deficit and the expected expansion in oil and gas production, total public debt will still remain high over the program period, dropping to 62.6 percent of GDP in 2017 from 69.6 percent of GDP in 2015, but will reach a more sustainable level of about 50 percent of GDP within a decade (Table 2).

Table 2 Ghana: Selected Program Economic and Financial Indicators, 2015-2017

Indicator	2015	2016	2017
Real GDP growth (%)	3.5	6.4	9.2
Real GDP growth (non-oil; %)	2.3	4.7	5.5
Inflation (end period; %)	12.0	8.6	8.2
Broad money (M2+; % change)	22.3	23.6	20.9
Revenue (% of GDP)[a]	19.2	19.6	20.0
Expenditure (% of GDP)[a]	26.7	25.4	23.7
Primary balance (% of GDP)[b]	0.9	1.7	3.2
Overall balance (cash: % of GDP)	-7.5	-5.8	-3.7
Net domestic financing (% of GDP)	4.8	3.5	2.1
Central government debt (gross; % of GDP)	69.6	67.5	62.6
External current account balance (% of GDP)	-7.0	-6.2	-4.9
Gross international reserves (US$m)[c]	4,734	5,822	7,544
Months of Import Cover	3.1	3.5	4.2

Source: IMF (April 2015); a: excludes tax exemptions, internally generated funds, and tax refunds; b: on commitment basis; c: excludes petroleum funds and encumbered assets

According to the IMF, Ghana's 2015 Budget approved by Parliament in November 2014 was ambitious and included significant measures to achieve strong fiscal consolidation. On the revenue side, the measures include the imposition of a special petroleum tax of 17.5 percent as part of the rationalization of the VAT regime and changes in the petroleum products pricing structure; the implementation of the VAT on fee-based financial services and the imposition of a 5 percent flat rate on real estate to broaden the tax base; and the extension to 2017 of the special import levy of 1–2 percent on some imported goods and the 5 percent national fiscal stabilization levy on profits before tax of banking, insurance, other financial services, communication and brewery sectors. Other revenue measures contained in the Budget include an increase in withholding tax on directors' fees from 10 percent to 20 percent and on goods and services from 5 percent to 7.5 percent; increase in vehicle income tax by 5 percent; and a proposal to review corporate income tax for the free zones companies (GoG, March 2015).

On the expenditure side, the government will limit the nominal increase in the total wage bill to 10 percent, supported by (i) an agreement with trade unions on a 13 percent wage increase over the 2013 nominal basic wage in 2015; (ii) discontinuation of the 10 percent cost of living allowance granted in 2014; and (iii) strict limit on net hiring in the public sector (which will be frozen except in education and

health). Moreover, subsidies for utilities and petroleum products will be fully eliminated through strict implementation of tariff and price adjustment mechanisms (quarterly and bi-weekly adjustments for utility tariffs and petroleum products prices, respectively) to eliminate subsidies (GoG, March 2015).

The government will use part of the resulting fiscal space to support social and other priority spending under the program, including expanding the targeted social safety nets - such as the flagship cash transfer program, the Livelihood Empowerment Against Poverty (LEAP) benefitting the poorest households and which will almost double its coverage to 150,000 households in 2015 - and protecting basic health care coverage (IMF, April 2015).

The government will also clear all the outstanding stock of payment arrears over the program period through cash payments and possible securitization of arrears to SOEs with marketable financial instruments. About a quarter of outstanding arrears would be repaid in 2015 after being subjected to a thorough auditing.

The government adopted additional measures to mitigate the budget revenue shortfall due to the substantial decline in oil prices since the budget was adopted. To mitigate this shortfall estimated at 2 percent of GDP and ensure that total debt accumulation remains in line with the level approved in the Budget, the government will implement the following measures:

- Reduce goods and services as well as domestically-financed capital spending by the equivalent of 0.3 and 0.7 percent of GDP, respectively— which the government has already started implementing by reducing the spending allotments to ministries in line with lower oil revenues;
- Reduce transfers to other government units by 0.2 percent of GDP in line with lower revenues; and
- Finance the remainder of the shortfall by drawing from the Oil Stabilization Fund (in line with the Petroleum Revenue Management Act).

The government also stands ready to adjust its policies further in the event of any further budget shortfall.

3.2 Public financial management reforms

Public financial management framework: To support the fiscal adjustment effort, the government plans to adopt various measures to reform the Public Financial Management (PFM) framework. The PFM reforms implemented over the past years have yielded limited benefits, and a recent Public Expenditure and Financial Accountability (PEFA) assessment revealed that there are significant public finance management gaps in terms of credibility, predictability and control over budget execution that need to be addressed in order to:

- Signal the urgent need to reform the PFM system, the Ministry of Finance will submit to Cabinet a comprehensive PFM reform strategy for approval by August 2015 and draft bills to deal with the weaknesses in the existing PFM laws by December 2015.

- Restore budget credibility and avoid significant overruns during the year, the medium-term fiscal framework and its forecasting models will be strengthened. The government also plans to communicate for information the Budget Strategy Paper for the 2016 fiscal year to Parliament by end-July 2015.

- Increase control over budget execution and avoid the accumulation of new arrears, only purchases generated by the Ghana Integrated Financial Management System (GIFMIS) will be recognized as valid commitments of government. The government will also extend the GIFMIS system to revenue and expenditure transactions of internally generated funds (IGFs) to progressively enhance budget comprehensiveness.

The Ministry of Finance will also strengthen Treasury and cash management by gradually centralizing cash holding in the Treasury Single Account (TSA) and draft jointly with Bank of Ghana a new strategy paper for the adoption of the TSA by August 2015.

Improving budget transparency: Starting with the 2016 budget, government will publish information on all tax expenditures, their beneficiaries and their associated fiscal costs, in accordance with international best practices. Financial information on all existing subvented agencies will also be published. The Ministry of Finance will improve the production and timely publication of fiscal data, including: revenues and expenditures of local governments and extra-budgetary funds; financial statements of SOEs; public investment plans and wage bill performance reports and those data not yet publicly available. The government will also continue to follow the recommendations of the Extractive Industry Transparency Initiative (EITI) with regard to the management of natural resource revenues.

Payroll clean-up and enhancement of wage bill control: Various payroll irregularities have been identified in recent years. In 2012, the government started a reform and modernization of the payroll by identifying and eliminating ghost workers and transferring the records of most civil servants into a centralized database. The government authorized several audits that identified weaknesses in the security, validation, and performance of the existing payroll databases. In addition, inadequate and infrequent controls by heads of units before payment of salaries have resulted in duplicate names, employees with no or incorrect bank accounts, identical bank accounts related to several employees or instances of double payment of salaries which were common with the payroll system.

In March 2015, the Inter-Ministerial Committee on Payroll issued a payroll plan that is aimed at resolving the payroll irregularities. Key elements of the plan are the following:

- Removal from the payroll of names of public employees with no bank account;
- Suspension and verification of salary payments to employees with no social security numbers;
- Implementation of a biometric validation of all employees on the mechanized payroll;
- Rolling out of an electronic wage payment system to ensure a monthly validation by all department heads of their staff (including grades) before payments are made;
- Assessment of the security of the payroll system through an audit of the payroll databases, which were merged in 2014;
- Introduction of new guidelines to strengthen internal control over the payroll processes; and
- Large scale public audit of the payroll management to provide evidence to assist in identifying government officials responsible for irregularities as a basis for any legal actions the government may take.

To ensure better control over the public sector workforce and the wage bill, personnel records in all sub-vented agencies are to be integrated with the existing payroll databases and the progressive roll out of the Human Resource Management Information System (HRMIS) is envisaged to enhance control over net hiring in the public sector. In the meantime, no new personnel are to be added to the payroll without proper financial certification. Starting in 2015, the government also intends to align wage negotiations with the budget cycle and have them cover a 3-year period on a rolling basis.

Civil service reform: The government aims at bringing the wage bill (excluding arrears and social benefits)-to-domestic revenue ratio down from 39.5 percent in 2014 to 35 percent over the medium term, in line with the regional ECOWAS target. This will require wage restraint over the full three-year program period, with increases consistent with expected inflation. To also help achieve this objective while improving public services, government will design a civil service reform strategy during 2015 with the assistance of development partners, which will aim at increasing the productivity and rationalizing the size of the civil service. As part of this reform, the government intends to review the functions of subvented agencies. A task force will be set up to examine the issue and provide recommendations on the right-sizing exercise to the government.

Restructuring of Statutory Funds: The national budget is currently characterized by several rigidities, limiting room for policy maneuver. Besides the high level of mandatory expenditures related to wages and interest payments, the Statutory Funds receive almost 20 percent of earmarked revenues. Government will undertake a restructuring of the Statutory Funds, which will include a review of the administrative and legal framework protecting their funding and operations by June 2015. The aim of this exercise is to introduce more flexibility and efficiency in the overall fiscal management of Statutory Funds and to enhance their transparency and accountability commencing in 2016.

3.3 Improving revenue collection

Tax policy: The Ghanaian tax system is fundamentally sound and is based on the essential pillars of a modern tax system. However, the system is undermined by reliance on discretionary tax treatments, in the form of exemptions, special regimes and tax holidays (amounting to some 6 percent of GDP), which hinder economic efficiency, fair competition and revenue mobilization. Government intends to broaden the tax revenue base and create a level playing field. The government will review the existing tax exemptions and streamline the tax treatment of the free zones enterprises and SOEs.

Natural resource management: Since oil production came on stream in 2011, the Petroleum Revenue Management Act (PRMA) has raised a number of operational issues, including the calculation of the benchmark revenue to be included in the budget and rigidities of the system in allocating funds to the budget and to the petroleum funds, viz. Stabilization and the Heritage Funds. The law led the government to transfer revenues to the petroleum funds while running large deficits in 2012–2014. No revisions in the benchmark revenues on which some spending is directly based are allowed under the current framework even in cases like the recent decline in oil prices. Government has therefore submitted to Parliament amendments to the PRMA, including the option to give the Minister of Finance more discretion to amend the benchmark revenues under unexpected circumstances.

Tax administration: Government intends to accelerate tax administration reforms which had stalled in the past years. The Ghana Revenue Authority (GRA) has developed a new Strategic Plan covering 2015–17, with intensive IMF technical assistance. The Plan, which focuses, among other things, on improving tax compliance and further modernizing tax collection was to be submitted to the GRA Board for approval by March 2015. To improve administration efficiency, the VAT threshold will be increased after the new tax policy for small business is enacted. To restore the integrity of the VAT regime, the authorities will seek technical assistance to implement time-bound refunds of VAT credits by September 2015.

3.4. Debt management policy

In view of the high level of public debt, a prudent borrowing strategy will be implemented, relying on concessional borrowing to the extent possible and prioritizing non-concessional borrowing for highly productive development projects.

The program is fully financed through a combination of external concessional loans and domestic financing, as well as limited non-concessional external borrowing in line with the Fund's applicable debt limit. The Fund's debt sustainability analysis (DSA) indicates that Ghana is at a high risk of debt distress, on account of breaches in the debt-service to revenue ratio over the program period and after 2021. The government is therefore committed to limit its borrowing plans to loans with a minimum grant element of 35 percent, with possible exceptions in line with the debt limits policy. The government has already secured significant program grants and loans from its development partners for 2015, with most of them frozen since 2013. In addition, the government plans to issue a Eurobond to raise US$1.0 billion during the second half of 2015 as a substitute to domestic borrowing to help repay expensive maturing debt. The Ministry of Finance is also working to identify high priority development projects which cannot be

financed by relying only on concessional borrowing. The Bank of Ghana's gross financing to the budget in 2015 will be limited to 5 percent of previous year's revenue, using only marketable financial instruments. The rest of the domestic financing of the fiscal deficit will be from deposit money banks and non-banks through the issuance of Treasury bills and bonds. To this end, the government will strive to deepen the domestic bond market with technical assistance from the Fund (IMF, April 2015).

To safeguard the government's overarching goal for debt and fiscal sustainability, the Ministry of Finance will develop a comprehensive medium-term debt management strategy and submit to Cabinet for approval by end-June 2015. Plans to deepen the domestic debt market will also contribute to reducing refinancing and exchange rate risks, while securing a more stable source of financing over the medium term. The government also intends to strengthen its risk management practices by developing an operational framework for building cash buffers, strengthening the management of the on-lending portfolio, and reducing the exposure to contingent liabilities by minimizing the use of sovereign guarantees (IMF, April 2015).

3.5. Monetary policy and exchange rate regime

BoG monetary policy will continue to be underpinned by inflation targeting. The policy aims at achieving a single digit inflation rate over the medium term, with the support of the government's fiscal consolidation. The Bank announced a medium-term inflation target of 8 percent to increase transparency and help anchor inflation expectations and exchange rate stability. For 2015, however, inflation is projected to reduce to 12 percent. Guided by inflation forecasts, the Monetary Policy Committee (MPC) of the BoG will take all decisions on reference interest rates and the interest rate bands. The Bank will also strengthen its monetary operations to steer the interbank rates towards the policy rate. To this end, BoG will run all its liquidity operations using BoG bills, while eliminating the open market operations bills (Treasury bills issued for monetary operations purposes). This policy is designed to increase transparency and clearly distinguish monetary operations from the placement of public debt bonds. The currently existing two-week fixed rate BoG-bills will remain the main instrument for liquidity management. The MPC will determine both the monetary policy rate and a more transparent overnight interest rate corridor.

The government's objective to bring inflation back into single digit territory will be supported by the move to restore the effectiveness of the inflation-targeting framework. To this end, first, the central bank financing of the government and state-owned enterprises will be progressively eliminated. A Memorandum of Understanding between the Ministry of Finance and BoG, limiting the Bank's financing to 5 percent of previous year's revenue in 2015 and the adoption of a new Bank of Ghana Act to bring the financing to zero from 2016 onwards, will be concluded.

Second, the BoG will strengthen the interbank foreign exchange market and use market transactions to determine the daily official exchange rate. This is aimed at deepening the exchange rate market by unifying the BoG and the interbank exchange rates. BoG has since January 2014 begun the implementation of the online foreign exchange trade tracking system, which is envisaged to lead to an improvement of the operations of the foreign exchange market by enhancing transparency and price discovery among market participants. A crucial step will be the elimination, by June-2016, of the compulsory surrender requirements of foreign exchange for key sectors of the economy and an end to the BoG's practice of securing foreign currency funding for priority sector imports. BoG's management also defined in early March 2015 a fixed set of rules to compute a daily reference foreign exchange rate for the cedi against the major trading currencies based on market transactions for immediate implementation. This will fully unify the BoG and the interbank foreign exchange rates.

Third, a new Act designed to significantly strengthen BoG's functional autonomy, governance, and ability to respond to banking sector crisis will be submitted to Parliament for consideration and approval by end-December 2015. In addition to institutionalize the zero limit on government financing and limits on BOG

financing to public institutions from 2016 onwards, the new Act will strengthen governance provisions to ensure the personal autonomy of key Management staff, Board and Audit Committee members of the Bank. The Act will have new provisions which will allow the Bank to better respond to banking crisis situations, including the details and conditions under which it will provide emergency lending assistance. The requirement in the BoG Act for the Bank to set annual aggregate limits for its guarantees for foreign loans by the government will be enforced.

3.6. Preserving the financial sector's stability

To address concerns about banks' balance sheets, BoG and external audit firms will undertake a special diagnostic audit of loan classification and provisioning and of restructured loans. Informed by this audit, which is planned to be completed by September 2015, BOG will develop new regulations to ensure that banks meet prudent standards in their underwriting and credit evaluation practices, and are not under-provisioning. BoG is strengthening its oversight of the microfinance institutions and has created a dedicated department for rural and microfinance supervision. The Bank will continue to strengthen cross-border and cross-sector supervision by intensifying its collaboration with central banks and regulators in the sub-region, as well as with other domestic financial sector regulators.

BoG is committed to strengthening the legal framework for supervising and regulating the financial system. To this end, the Banks and Specialized Deposit-Taking Institutions Bill and the Ghana Deposit Protection Bill will be presented to Parliament during the second quarter of 2015. These laws clarify the current legal framework for financial institutions and provide the BoG with strong, comprehensive and flexible tools for regulation, supervision and resolution in line with international best practices. The resolution tools will give BOG the capacity to protect the value of performing assets and protect depositors while removing weak banks from the system. The Deposit Protection Bill, which will have long term benefits for financial stability, has also been drafted and will be submitted to Parliament for adoption by mid-2015. The draft law establishes a separate institution, the Ghana Deposit Protection Corporation, with its responsibility limited to protecting deposits.

3.7 Prior actions, quantitative targets, and structural benchmarks

The program contains three sets of conditionalities, comprising prior actions, quantitative targets and structural reform benchmarks. The government was required to implement eight prior actions, including implementing the fiscal adjustment in 2015, clean-up the payroll, limit monetary financing, and strengthen the inflation targeting framework. As at mid-April 2015, all the eight prior actions had been completed (see Table 3).

Table 3: Ghana: Prior Actions

Action	Status
1) Adoption of a 2015 Budget consistent with the agreed front-loaded fiscal consolidation path, including the agreed revenue measures underpinning it (i.e., a budget deficit of GH₵7,117 million, equivalent to 5.3 percent of GDP, on commitment basis).	Completed
(2) Adoption of an agreement establishing a ceiling of 5 percent of previous year's budget revenue for monetary financing of the budget through government overdrafts or loans from Bank of Ghana in 2015 (continuous ceiling).	Completed
(3) Institution and implementation of a strictly rules-based method using market transactions to determine BOG's official exchange rate.	Completed

(4) Implement petroleum products price structure reflecting full cost-recovery, including the VAT on petroleum products.	Completed
(5) Announce a medium-term inflation target, endorsed by Ministry of Finance.	Completed
(6) Cabinet approval and public announcement of additional adjustment measures amounting to GH₵1,265 million to mitigate the impact of lower oil prices and keep total public debt accumulation as approved in the 2015 budget.	Completed
(7) Finalize the validation process of public employees with no bank account that will be removed from the payroll and publish a report on the clean-up, including the number of public employees suspended or under investigation.	Completed
(8) Publication by the Inter-Ministerial Committee on the payroll of the plan to clean-up the payroll and strengthen its management prepared by the Controller and Accountant General.	Completed

Source: IMF (April 2015, Table 1 p.71)

The program will be monitored based on periodic performance criteria, continuous performance criteria and indicative targets. Quantitative performance criteria have been set for the primary fiscal balance, wage bill, net international reserves, and net domestic assets of the BoG (Table 4). While the focus of BoG's policy will be on achieving the inflation objective, the program will initially include a performance criterion on net domestic assets (NDA) of Bank of Ghana as a safeguard mechanism. Following successful implementation of monetary sector reforms, as envisaged by BOG by the time of the second review, and a reduction in inflation, the program could be in a position to shift to monetary policy consultation clause conditionality.

The performance criteria under the program include the following:

- A floor on the primary fiscal balance (cash) of the government, measured in terms of financing;
- A ceiling on gross credit to government by the Bank of Ghana (level);
- A floor on the net international reserves of the Bank of Ghana (level);
- A ceiling on net domestic assets of Bank of Ghana (level);
- A ceiling on wages and salaries;
- A ceiling on the net change in the stock of domestic arrears;
- A continuous non-accumulation of domestic arrears;
- A continuous non-accumulation of new external arrears; and
- A ceiling on the contracting or guaranteeing of new external non-concessional debt

The indicative targets established are also as follows:

- An indicative target is set for the twelve-month rate of consumer price inflation, with discussions with the Fund to be held if inflation does not reach the target.
- A floor on poverty-reducing government expenditures.

To monitor progress on the structural reforms, structural benchmarks are applicable (see Table 5). The structural conditions focus on strengthening public financial management, cleaning up the payroll, enhancing revenue collection and broadening the tax base, rationalizing the civil service, and strengthening debt management and the monetary policy framework.

Table 4: Ghana: Quantitative Program Targets

Item	2014	2015		
		April	Aug.	Dec.
1. Quantitative Performance Criteria				
Primary fiscal balance of the government (floor; GH₵m)	-3,555	-544	-380	-422
Wage Bill (ceiling; GH₵m)	9,449	3,413	6,857	10,286
Net international reserves of the Bank of Ghana (floor; US$m)	1,415	1,042	331	1,962
Net Domestic Assets of Bank of Ghana (ceiling; GH₵m)	3,095	5,755	8,772	4,914
Net change in stock of arrears (ceiling, GH₵)	428	-424	-1,001	-1,561
2. Continuous Performance Criteria				
Gross financing of BoG to government and SOEs (ceiling; GH₵m	13,603	14,614	14,614	14,614
Non-accumulation of external arrears (ceiling; US$m)	-	0	0	0
Non-accumulation of domestic arrears (ceiling; US$m)	-	0	0	0
Contracting/guaranteeing of new external non-concessional debt (ceiling; US$m)	-	0	1,000	1,000
3. Indicative Target				
Program central target rate of inflation (12 month% change)	17.0	15.4	13.8	12.0
Social Protection (floor, GH₵m)	947	388	806	1,294

Source: IMF (April 2015, Table 2, P. 72)

Table 5: Ghana: Structural Reforms Benchmarks, 2015-16

Category	Possible Structural Benchmark	Economic Rationale	Indicative Time Frame
Revenue administration and tax policy			
Revenue administration	Adoption of the presumptive income tax, followed by revision of VAT thresholds	To enhance compliance in tax	August 2015
Tax policy	Identify exemptions to SOEs and free zone companies that will be eliminated in 2016, to be included in the 2016 budget and further eliminate GIPC's role in granting exemptions.	Broaden tax base	September 2015
Public financial management (PFM)			
Human resource management	Finalize roll out of the HRMIS to remaining MDAs	To strengthen the control on net hiring and the wage bill.	December 2016

	Integration of the GIFMIS payroll, financial HRMIS and Hyperion in the Health and Education sectors.	To strengthen the control on net hiring and the wage bill.	June 2016
Payroll Management	Audit of the payroll database and security system.	Improve security of the payroll system	May 15, 2015
	Biometric validation of all employees on the mechanized payroll, as well as publication of the public audit of payroll management	Cleaning of the payroll Database	June 2015
PFM reform strategy	Migrating employees of sub-vented agencies into the mechanized payroll	To strengthen control on net hiring and the wage bill	December 2015
	Approval by Cabinet of a new PFM reform strategy and action plan, including a strategy for completion of the Treasury Single Account (TSA)	To revamp PFM reform effort	August 2015
Legal framework	Approval by cabinet of drafts of Bills to amend existing PFM legal framework with the aim to: clarify the scope of application of the legislation and the institutional arrangements; strengthen budget formulation and execution, treasury management, accounting and reporting; introduce provisions on fiscal responsibility and on debt management	To strengthen the PFM system	December 2015
	Public service reform		
Civil service reform	Adoption by Cabinet of a comprehensive civil service reform strategy designed with the assistance of development partners	To rationalize and increase the efficiency of public sector	December 2015
	Debt management		
Debt management strategy	Approval by Cabinet of a medium-term debt management strategy with clear risk priorities and plans on how these will be addressed, and its publication	To have a clear financing strategy communicated with the market to reduce uncertainty and borrowing costs	June 2015
	Monetary policy and financial sector		
Bank of Ghana Act	Submit to Parliament a revised Law that strengthens the functional autonomy of BOG; sets a zero limit on monetary financing to the government and public institutions; establishes appointment durations for Governor and Board members; sets rules for emergency lending to banks in distress; and ensures compliance with IFRS.	Strengthen autonomy of the bank; set mechanisms for emergency lending	December 2015
Exchange rate	Adopt a plan to eliminate the compulsory requirement of foreign exchange to BoG and	Support market-based	April 2015

	stop provisions of foreign currency funding for priority sector imports.	determination of the exchange rate and deepening of the foreign exchange market.	
Prudential Supervision	Submit to Parliament a new Banks and Specialized Deposit-Tackling Institutions Bill which provides BOG with the authority for prompt corrective action, liquidity support instruments; clear triggers for bank resolution; and a range of bank resolution tools.	Strengthen the legal framework for prudential supervision	May 15, 2015
	Submit to Parliament a Deposit Insurance Bill which is consistent with the Banks SDI Bill; that establishes an institution with the responsibility of paying deposits from recovered assets of failed banks; and ensures that incentives are appropriate and does not undermine market discipline		May 15, 2015
Diagnostic Review	Complete an asset quality review of the banks, undertaken by independent third parties, in consultation with IMF staff	Ensure prudent standards in bank's underwriting and credit evaluation practices	September 2015

Source: IMF (April 2015)

3.8. Risks

The program recognizes that the short and medium-term economic outlook is subject to substantial risks. On the downside, if the current electricity crisis is not swiftly addressed and energy sector reform is delayed, growth may be even lower than projected in 2015 and not rebound as quickly as expected thereafter. The deceleration in growth in 2015 may also weaken the financial sector with increasing non-performing loans, limiting its ability to support private sector activity and continue to provide budget financing. The run-up to the elections in 2016 may lead to social tensions and a strong push for policy reversal (previous election cycles have seen fiscal overruns). Moreover, with exports dominated by commodities, the country remains exposed to terms of trade shocks. An abrupt increase in global financial market volatility leading to lower private capital inflows, a sustained decline in key commodity prices (gold, cocoa, and oil), and economic slowdown in main trading partners would also have a substantial negative fiscal impact in the medium term. Changes in global financial conditions could also increase financing costs as concessional resources are drying up for the country. On the upside, quickly regaining credibility of fiscal discipline and monetary policy may lead to a more rapid decline in domestic interest rates and restoration of investors' confidence. A stronger rebound in commodity prices over the medium term, including oil, would facilitate accelerating some development projects (IMF, April 2015).

4 Observations

4.1 Need for a program

The move by the government to seek external assistance from the IMF was no doubt a positive one and may come as a huge relief to the country and the investing community. The decision was not only about the balance of payments support to save the domestic currency from further depreciation, but also to

strengthen public finances and ensure fiscal discipline in order to restore economic stability and growth. In this way, the program advances policy credibility and confidence of the international community in the economy. The engagement with the IMF is a process meant to agree on a program which will include access to the Fund's resources as well as bringing to the markets the awareness that some external agency has agreed to chip in to help alleviate the economic challenges. Of course, the Fund support comes with some conditions, which seek to ensure that the commitments agreed upon are honored (Botchwey, 2014).

As Botchwey observed, the IMF support is required to demonstrate certainty, gain policy credibility, and shore up international confidence in the country's economic management. The road ahead, however, looks to be long and challenging. Over the next three years, the Fund will undertake several reviews to establish the effectiveness of the program implementation, in terms of meeting the set conditionalities (targets and benchmarks) before the full benefit of the US$918 million loan can be reaped. Already, skepticism over government's commitment to the Fund deal is growing among the international community amidst predictions that the strong fiscal tightening that the program prescribes will be politically difficult to implement (see, The Economist Intelligence Unit, April 15, 2015; Fitch Ratings Limited, February 27, 2015)

4.2 Economic Growth

One is not sure that the GDP growth target of 6.4 percent in 2016 rising to 9.2 percent in 2017 can be achieved. The last two years have seen a sharp slowdown of economic activity, accelerating inflation, rising debt levels and financial vulnerabilities. Economic growth in 2014 slumped to 4.0 percent, caused by a sharp contraction in industrial and services activities, which itself was due largely to the negative impact of currency depreciation on input costs, declining domestic demand, and increasing power outages. The slowdown of the economy is predicted by the Fund to continue in 2015, with the growth rate reaching 3.5 percent.

According to the Fund, the front-loaded nature of the fiscal consolidation and expected financial support from development partners should help mitigate program risks and foster broad-based growth in the medium term. The growth prospects in the medium term look positive, especially with the coming on stream of the Tweneboa, Enyenra and Ntomme oil field in the second half of 2016 and the Sankofa offshore gas project which will commence production in 2017. The increased oil and gas production is expected to ease the downward pressures on the country's foreign exchange buffers, and this together with lower inflation and interest rates, and a more stable exchange rate will also support the recovery of economic growth in the medium term. Despite this, it is not certain that the projected real GDP growth targets in 2015 and over the medium term can be achieved unless the energy sector reforms are implemented successfully, the conduct of monetary policy is directed to enhance efficiency in the banking industry in order to ensure cost-effective delivery of credit, and the cedi depreciation is abated.

Although real GDP growth may benefit from foreign direct investment inflows in the off-shore oil and gas sector and from public investment in infrastructure, it seems doubtful that economic growth will reach 6.4 percent in 2016 and 9.2 percent in 2017 as projected in the program. According to the Bank of Ghana, the latest composite index of economic activity (CIEA) suggests a subdued pace of growth in economic activity between March 2014 and March 2015. Business and consumer sentiments have been mixed since the beginning of 2015. Business sentiments have softened while consumer confidence, though marginally up, remained subdued (BoG, May 2015). If the high interest rates, technical maintenance issues at the Jubilee oilfield, the problems encountered at the Atuabo gas plant, power and water shortages, as well as the negative impact of inflation on consumer and business confidence are

not addressed quickly and adequately, they will together constrain private domestic investment and in turn depress the country's growth prospects.

4.3 Fiscal consolidation

The IMF perceives forceful and sustained implementation of the program to be essential to address the country's macroeconomic imbalances and enhance investor confidence in view of the downside risks that the country faces. To the Fund, the frontloaded nature of the fiscal consolidation and expected financial support from development partners should help to mitigate the program risks, and foster broad-based, inclusive growth in the medium term.

In responding to questions posed to her by the Daily Graphic, the Managing Director of the IMF stated that "although Ghana made tremendous strides over the past 15 years and ranked among the fast-growing countries in Africa that have made significant progress in poverty reduction, the discovery of oil might have given the illusion that the public finance imbalances would get resolved easily". This, according to the Managing Director, may have weakened the sense of fiscal discipline. "But, in reality, oil revenues flowing to the budget have been relatively limited, compared with other oil producers. As a consequence, public debt has more than doubled since Ghana received debt relief in 2005", she added (see Daily Graphic, April 15, 2015). The IMF chief said "unfortunately, Ghana's large borrowing was not generally used for investments but rather to finance large recurrent spending, pointing out that the debt service, which was very high, further constrained spending in priority sectors such as social protection and key infrastructure". According to the Managing Director, what Ghana needs now to restore its economic health is strict implementation of measures agreed on under the new program. She said the country must also implement those measures intended to diversify the economy to reduce vulnerabilities. To her, the key to success lies in Ghana's commitment to put in place measures that address the underlying causes of the huge budget deficits we have seen in the recent past.

The sentiments expressed by the IMF Chief were re-echoed by the Fund's Director for the African Department in a briefing session on April 17, 2015. According to the Director, Ghana needs a considerable fiscal adjustment and needs to frontload that adjustment to deal with the very dire situation it has been in over the course of the last 2 to 3 years. She stated that the adjustment effort is frontloaded because Ghana's track record in fiscal adjustment has not been the best in the past. And it is very important as a signaling effect that there is consensus on the need to address the fiscal deficit issue and address it in a manner that minimizes the risk of the program going off-track as the country approaches elections next year. To her, the Fund does not think that the fiscal adjustment outlined in the program is over-ambitious. It is absolutely doable if the political and social determination is there to do it and they think there is. The issue of fiscal discipline and the political and social determination to implement strong fiscal adjustment in the country has thus been the concern of the IMF.

A number of interesting issues can be deduced from the sentiments expressed by the IMF. First, the call for a sizeable and frontloaded fiscal adjustment to restore debt sustainability implies that the fiscal deficit will be reduced at a faster pace than has previously been the case. According to the program's projections, the fiscal deficit will be reduced from 9.4% of GDP in 2014 to 7.5% in 2015, and then sharply to 3.7% of GDP in 2017. With this, the debt-to-GDP ratio is predicted to rise initially to a peak of almost 70% at the end of 2015, and thereafter decline slowly to 62.6% of GDP in 2017.

Given the exacerbating macroeconomic risks and vulnerabilities, a stronger fiscal consolidation is crucial to improve Ghana's public finances and restore macroeconomic stability, without which the economy cannot return to a path of sustained high growth that increases opportunities for employment. A stronger fiscal consolidation will also reduce debt-service costs, through cutting down the deficit and borrowing requirements, and place the public debt on a more sustainable trajectory. To this end, the objective of a

stronger fiscal consolidation is appropriate. The program however must be seen to be credible and the targets must also be realistic. The envisaged sharp reduction of the fiscal deficit target appears too optimistic, given the size of the projected expenditure cut, rising interest rates, clearance of arrears and the already damaged revenue outlook for 2015 by the precipitous fall in crude oil prices since July 2014.

Ghana's fiscal stance, in terms of deficits, debt stocks, and interest burden is weak. The weakness is attributed principally to the existing statutory liabilities such as wages and salaries, debt amortization, interest payments and the earmarking of a large chunk of the budgetary resources as statutory transfers. These items together have rendered the national budget inflexible to accommodate shocks and changes in government policy priorities, making the anticipated fiscal consolidation likely to be slow over the medium term.

Second, one cannot disagree with the need for the government to have the commitment and discipline to implement measures to restore the country's economic health. It is however baffling that a program that called for a strong front-loading of the fiscal adjustment ended up disbursing only US$114.8 million of the approved US$918 million, back-loading disbursement into the tail end of the program. Compared to Kenya's February 2015 case of a one-year US$688 million Standby Agreement/Standby Credit Facility where up to 78 percent of the total facility, amounting to US$535 million was disbursed upfront, one wonders why in Ghana's case only 12.5 percent of the total facility was disbursed upfront.

Third, the IMF is confident that the three-year program agreed between the Fund and Ghana will trigger the release of donor funds being held up. According to the Fund, when a country has negotiated the terms and conditions of a program and agreed to what is going to be good for its development, it generally and always triggers the release of funds that sometimes had been frozen or locked up, and that Ghana's program will have such catalytic effect. On the contrary, some of Ghana's donor partners have indicated that the country's deal with the IMF does not guarantee the release of frozen funds as there are other conditions that will influence disbursement of those funds. Also, currently some of the country's development partners have opted out of the system of transferring direct financial resources into government Treasury to support budget implementation under the Multi-Donor Budgetary Support program, while others have been reluctant to release funds promised under the program, citing endemic corruption and fiscal indiscipline as reasons for their refusal to release the promised funds (see B&FT, 21 April 2015). In any case, the planned donor support will decline steadily from 3.2 percent of GDP in 2015 to 2.2 percent of GDP in 2017 with no assurance of full disbursement.

Expenditure containment. As part of the expenditure rationalization exercise to support the fiscal consolidation, the program seeks to retrench expenditure, which stood at 31.2% of GDP in 2014, by 4.1 percentage points of GDP between 2015 and 2017. This new expenditure target is sizeable and more ambitious than the planned decline of 2.9 percentage points of GDP over the same period put forward by the government in the 2015 Budget. Total expenditure (including arrears payments), which had initially been projected at GH₵41.2 billion has been cut by GH₵1.5 billion to GH₵39.7 billion. The axe fell on capital expenditure which was cut by GH₵868.4 million, goods and services by GH₵344.0 million, and transfers to the Ghana National Petroleum Corporation by GH₵228.8 million. Ceilings on the other expenditure items—compensation of employees, subsidies, transfers to other government units, interest payments, and arrears expenditure— have largely been maintained, resulting in a deficit of GH₵10.0 billion, equivalent to 7.5% of GDP (see GoG, March 2015).

Accomplishing the new expenditure targets for 2015 and the medium-term will depend on the government's ability to tackle the structural causes of the high and growing wage bill, interest payments and statutory transfers. The government's high wage bill, linked partly to the introduction of a "single-spine salary structure" in 2010 that aimed at offering the same salary for the same position in the public sector continues to constrain fiscal flexibility. The related wage arrears accrued over the period and social benefits (social security payments and health insurance) continue to burden public expenses. To its

credit, the government has been able to curb the growth of the core wage bill (wages and salaries) since 2013 by restraining wage increases and minimizing overruns. This has led the wage bill-to-GDP ratio to be trimmed down to 8.3 percent in 2014 from 8.9 percent in 2012 (see Table 6).

Table 6: Compensation Expenditure (GH₵m)

Indicator	2010	2011	2012	2013	2014*	2015†
In million GH₵						
Compensation of employees	3,617.0	5,305.6	7,177.6	9,466.0	11,512.0	12,313.0
of which wages and salaries	3,182.5	4,534.9	6,665.5	8,334.0	9,448.6	10,286.5
As % of GDP						
Compensation of employees	7.9	8.9	9.5	10.0	10.1	9.2
of which wages and salaries	6.9	7.6	8.9	8.8	8.3	7.7

Source: (GoG, various issues) *Actual payments plus 0.9% of GDP wage-related obligations which were not settled; †Program Target

In terms of the overall compensation of employees' costs, however, the government has not succeeded in reining it in and seems to have resorted to compressing total compensation expenditure by withholding transfers to the Social Security and National Insurance Trust (SSNIT). While this strategy holds down the cash deficit, it does not alter the government's net worth. Moreover, these SSNIT arrears tend eventually to be securitized, with the result that the public debt stock is increased even if the borrowing is not reflected in the fiscal deficit. The agreement of a 13% wage increase in 2015 with public sector workers, calculated on 2013 basic pay levels, seems consistent with the wage expenditure budget, but given that the reported expenditure on compensation of employees in previous years did not give a true picture of all the government's liabilities, it is less clear whether the budgeted amount for total compensation in 2015 will be adequate to meet actual commitments.

Among the rigid expenditure items, interest payments have seen the most dramatic rise in the last few years, caused by the excessive government borrowing and monetary policy tightening in response to high inflation. As a percentage of domestic revenue, interest payments have risen from 15.7 percent in 2012 to a projected 34.5 percent in 2015. Ghana's Minister of Finance has himself expressed worry over the excessive rise in the country's interest payments, explaining that the cost at which the government loans and overdrafts were serviced remained the single most daunting challenge threatening the smooth and quick recovery of the economy. While emphasizing that government's prudent economic measures had helped to reduce the burden brought on the economy between 2011 and 2014 by the rising cost of subsidies, a burgeoning wage bill, an erratic power supply and a sharp drop in forex inflows, the Minister said interest payments still remained a bottleneck that needed to be fixed, else the planned recovery of the economy will not materialize (see Graphic Business, May 5-11, 2015). But, amid the prevailing inflationary pressures and strong demand by government for new domestic debt and debt refinancing not much can be done about the high interest rates in the short term. Rather, the control of interest expenditure hinges on successful fiscal consolidation, which will lower the government's borrowing requirements and improve macroeconomic stability, including the level of inflation.

With regard to obligatory transfers to statutory funds, which have also become a major source of expenditure inflexibility, the government, despite its pledge on countless occasions to take steps to

mitigate this problem, has rather worsened it by enacting two legislations in the past 15 months, viz. the Ghana Infrastructure Investment Fund Act and the Youth Employment Agency Act, which have added to the number of earmarked funds, putting enormous pressure on expenditure. The Infrastructure Fund is legally entitled to 14.3% of VAT revenues and 25% of the Annual Budget Funding Amount component of petroleum receipts. The Youth Employment Agency Act will also receive a portion of the CST and the District Assemblies Common Fund (DACF). The old statutory funds include the District Assembly Common Fund, the Ghana Education Trust Fund, the National Health Insurance Fund, and the Road Fund, all of which are protected by legislation. The upshot is that the budget will suffer from intense rigidity at a time when more expenditure flexibility is needed to be able to accommodate possible revenue shortfalls as the economy slows down.

The encumbrance of statutory transfers and quasi-statutory expenditures (compensation of employees' and interest payments) on domestic revenue has been growing, with the ratio of these expenditures to domestic revenue expected to reach 85.6% in 2015, implying even less of the already little room for fiscal maneuver and greatly impeding the fiscal consolidation effort. The government can no longer afford to dilly dally on the urgent matter of reviewing or amending the statutory funds and their legislations. The goal of the review should be to make the formulas for earmarks more flexible, especially to deal with situations where unanticipated revenue shortfalls put tighter-than-normal constraints on expenditure. Measures must also be introduced to make these funds more transparent, while their budgets and activities should be aligned more closely with the functions and objectives of their parent ministries, as well as the overarching goals of public expenditure.

Elimination of energy subsidies is an essential element of the planned fiscal consolidation. Yet this particular expenditure item is very susceptible to deviations from the budget because the political will to abolish subsidies has not been demonstrated, and in spite of the claims of deregulation and the implementation of the automatic price adjustment formula, prices of petroleum products, electricity and water are still administered and controlled by the government. There is therefore no way that subsidies can be avoided unless the government is going to compel fuel importers or utility companies to accept the underpricing losses. In fact, the under-budgeting for subsidies in the 2015 Budget, when the government knows that prices are being administered, is a recipe for the incurrence of arrears. Another problem with the current subsidies is the lack of transparency about what subsidies are in place at any given moment and their costs. A clear case in point is the difficulty of establishing the true debt owed by government to Bulk Oil Distribution Companies (BDCs) from the implementation of petroleum price subsidies. Not even government seems to know the actual size of this debt. Against this backdrop, it is important that the reform of the petroleum downstream sector is revisited and the role of government clearly delineated or the sector completely deregulated to promote transparency and accountability.

Another expenditure item about which there is little transparency is arrears payments. The fiscal program in 2009-12, which was also executed with IMF support, involved a substantial clearance of arrears, particularly in the energy sector and also related to wages. Approximately 3.0% of GDP was spent per annum between 2009 and 2012 to settle arrears (including SOEs liabilities), and these payments accounted for about 44.3 percent of the total cash deficit recorded in the period. The problem of arrears however persists, and in the past two years, total arrears equivalent to 2.6% of GDP was paid. What is worse is that an estimated stock of GH₵6.2 billion (5.5% of GDP) arrears is said to be outstanding as at end-2014. It is absolutely right therefore that the current Fund program has made non-accumulation of arrears a quantitative program target.

Domestic revenue mobilization. On the revenue side, the precipitous fall in crude oil prices since July 2014 has already done much damage to the revenue outlook for 2015, with the revenue and grants forecast for the year revised downwards by GH₵2.7 billion (1.7% of GDP). In its review of the 2015 Budget, the IFS judged the government's domestic revenue estimate for the year to be inconsistent with the predicted sharp slowdown of economic growth and therefore unrealistic (IFS 2014). This underlying risk to the fiscal program has not changed despite the diminished projections for oil revenue in 2015. The

reason is that the collapse of oil revenue has shifted the burden of revenue mobilization to the non-oil sector, but ironically non-oil GDP growth is expected to weaken considerably on account of the fiscal-adjustment measures and the continuing energy crisis. This gives little comfort that the non-oil sector will rise up to the challenge.

Growth in the non-oil sector is projected at 2.3% in 2015 as compared with 4.1% in 2014 and 6.7% in 2013. This notwithstanding, additional revenue of 4.1% of non-oil GDP (above the 2014 receipts) is targeted to be received from the sector, compared to 3.8 percent and 2.9 percent of non-oil GDP as revenue in 2014 and 2013, respectively, when the GDP growth rates were much higher.

Also, despite the extra tax measures introduced in 2014, non-oil domestic revenue as a share of non-oil GDP inched up by just 0.3 percentage points, with a non-oil GDP growth rate of 4.1%. Despite this weak outturn and a much slower non-oil GDP growth forecast of 2.3% in 2015, the government is targeting an increase of 1.1 percentage points in non-oil domestic revenue as a share of non-oil GDP. This seems very optimistic even if one takes into account the new taxes—particularly the special petroleum tax and the financial services VAT—that kicked in this year. The performance of those taxes, like all others, could also be affected negatively if the economy decelerates as envisaged.

Uncertainties regarding the size of tax-free allowances for up-front investment by oil exploration companies and crude oil price volatility also point to serious downside risks on projected oil receipts. We also believe that some of the fiscal measures contained in the 2015 fiscal program, such as increasing value-added tax rates, improving tax collection, and cutting fuel subsidies will not be enough to offset the higher cash wage and interest expenditures, while some are designed to shift expenditures off-budget rather than to improve spending efficiency. As pointed out already, the fiscal consolidation effort will take place in the context of a slow growth environment which will dampen revenue generation capacity. The country's debt sustainability level is also among the weakest in the developing world, with annual interest payments amounting to about one third of total revenue and grants. External vulnerabilities and low growth also add to the fiscal weakness. The underlying problems of the slow growth and the inability to implement strong fiscal adjustment are thus mainly structural in nature that short-term measures cannot fully address the problems. Even with the discipline, political and social determination, the fiscal deficit targets and GDP growth projections set under the program will be difficult to achieve within such a short period of three years. A more gradual fiscal consolidation path over the medium term would have been more realistic.

4.4 Bank of Ghana inflation targeting framework

The high rates of inflation experienced in the country since 2013 have eroded the value of incomes of many Ghanaians. The targeted reduction to single digits by the end of 2016 and about 8% in the medium-term is therefore appropriate and necessary to halt the decline in real incomes and living standards. It is however hard to foresee how the inflation targets can be achieved given the strong negative pressures that the perceived weakness of the cedi, high interest rates, and higher energy input costs will put on the domestic consumer price index. Headline inflation stood at 16.6 percent in March 2015 from 16.4 percent in January 2015, driven by both food and non-food inflation. Core inflation (CPI excluding energy and utilities) has risen since January 2015, giving an indication of the underlying pressures. Inflation expectations have heightened across consumers, businesses and the financial sector, with upward implications for pricing behavior in the medium (BoG, May 2015).

It is not surprising that the IMF program has called for a further monetary tightening on top of what is already perceived as a tight monetary stance. In fact, the IMF Board mentioned in its 2014 Article IV report that it welcomed the government's recent monetary policy tightening and went further to suggest that further tightening may be needed, in combination with fiscal consolidation to steer inflation back to the target range (See IMF, May 2014). The Fund believes that the combination of both tighter monetary

and fiscal policy would help to drive inflation back to the single-digit zone over the medium term. This view seems to be supported by the Bank of Ghana which concluded at its May 2015 Monetary Policy Committee meeting that the risks to both inflation and growth are elevated, but tilted more to inflation. It was therefore noted by the Committee that a further moderate tightening, complemented with sustained fiscal consolidation efforts could rein in inflation and inflation expectations. Consequently, the Committee raised the monetary policy rate from 21 percent to 22 percent (BoG, May 2015).

Inflation targeting framework requires a clear understanding of the monetary policy transmission mechanism to achieve a target rate of inflation with the use of monetary policy instruments, notably interest rates. In addition, the traditional channels of monetary transmission through interest rates, bank lending and asset prices require workable institutional frameworks, functioning money and securities markets, and a reasonably competitive banking sector where interest rates respond to changing market conditions and funds are channeled from savers to borrowers as credit.

The implementation of the inflation targeting framework since 2007 has not resulted in a more fundamental change in liquidity management, which continues to be based on reserve money targeting. Most banks participate in the interbank market, which is predominantly overnight and securitized. Payment and settlement arrangements are advanced and an auction market for treasury securities is functioning well. There are, however, some continuing difficulties with forecasting government expenditures and no systematic analysis is undertaken of forecasting errors. Concerns about the cost of sterilization appear to have at times impacted on BoG's operations to mop up excess liquidity, and these concerns threaten to undermine the pursuit of Bank's price stability mandate. More importantly, interbank rates have deviated from the policy rate by more than the targeted corridor, and the policy rate has been overtaken by the Treasury bill rates as the benchmark for market interest rates.

In order to stabilize short term interest rates close to the policy rate, the central bank needs to target banks' excess reserves, and forward-looking liquidity operations should aim in the longer run to comply with any target path for other monetary variables, such as reserve money. Improved forward-looking liquidity forecasts would include daily forecasts of excess reserves and composition of reserve money, and forecast error. Moreover, while the BoG has available traditional instruments of monetary policy, some redesign and adjusted use of these instruments could be useful for liquidity management including the establishment of standing overnight lending and deposit at interest rates linked to the policy rate; use of repos and reverse repos transactions only on the initiative of the central bank and restricted to bank participation; and an extension of the maintenance period for reserve requirement from one week to at least two weeks while continuing to allow banks to meet the requirement on average over the longer maintenance period (IMF, 2013).

Monetary policy implementation has also been subject to large swings in recent years. During 2011, monetary policy was gradually loosened, and interest rates fell to low levels because of the achievement of fiscal consolidation which saw a moderation in domestic borrowing by the government. In the first half of 2012 however, considerable pressure was built up in the foreign exchange market, and the currency began to depreciate. Since then, the BoG tightened monetary policy by increasing the policy rate and intervening in the foreign exchange market. In addition, measures directed toward supporting the domestic currency market were introduced, including changing the denomination of required reserves on foreign currency deposits from foreign to domestic currency and imposing a 100 percent domestic currency cover for banks' vostro accounts. Although the exchange rate was stabilized, interest rates continued to increase, also driven by increased government borrowing.

Interventions in the foreign exchange market should also support the achievement of the BoG's monetary policy objectives. Empirical studies have shown that the pass through to domestic prices from exchange rate changes is strong and rapid in Ghana, which underscores the link between a stable exchange rate and price stability. In an inflation targeting system however, it is important that this stability is primarily

achieved through appropriate macroeconomic policies and not by directly managing the exchange rate. The effective functioning of the foreign exchange market with transparent price discovery in the wholesale interbank market and supportive interventions by the central bank will facilitate risk-taking and confidence by economic agents.

Given the close link between exchange rate and price movements in the country, a weakening currency could result in a build-up of inflationary pressure and hence justify BoG's action. Furthermore, direct interventions in the foreign exchange market can complement the interest rate transmission channel. However, targeting a particular level of the exchange rate would be inconsistent with an inflation targeting regime. The BoG may still find it necessary to intervene in the foreign exchange market to ensure order in the market, as bulky transactions in a shallow market could disrupt the market and lead to large swings in the exchange rate unrelated to economic fundamentals. In these situations, it is important to communicate clearly the BoG's objectives and to emphasize that in the context of a floating exchange rate regime the BoG is not targeting any particular exchange rate level, but intervening in the market to reduce volatility.

4.5 Cedi depreciation

There is no concrete assurance that the pressure on the cedi will abate under the program. As it is well known, the weakness of the domestic currency is a result of the macroeconomic imbalances, in terms of large fiscal and current account deficits leading to rising interest rates and mounting public debt. As we have argued earlier, the much-talked about front-loaded fiscal adjustment is unlikely to hold. Also the balance of payments support is not too strong. Therefore, there will not be any strong positive impact on the domestic currency. We also note from the IMF's 2014 Article IV consultation report that, the Executive Board of the Fund was of the opinion that the Ghanaian authorities should "continue to allow the exchange rate to adjust to prevent further erosion of the reserve buffer" (IMF, May 2014). This opinion suggests that the cedi will not gain significant strength until the country's macro fundamentals begin to show signs of strong improvement. Furthermore, it is expected that the inflow of the 2015 Eurobond proceeds together with the initial disbursement of the US$918 million facility will provide some respite for the cedi which has already slumped by close to 20% since the beginning of the year. Unfortunately, many analysts are of the view that if what happened after September 2014 with respect to the Eurobond and the cedi exchange rate is anything to go by then the 2015 US1.0 billion Eurobond proceeds and the Fund's US$344.0 million support for the year will have no sustainable positive impact on the value of the cedi, and indeed the fear is that the worst of the cedi depreciation is yet to come.

4.6 External sector and economic diversification

The main goal of external sector program is to build adequate international reserve buffers over the medium term to strengthen the economy's capacity to withstand external shocks. Accordingly, gross international reserves (excluding oil funds and encumbered assets) are projected to increase by nearly 75 percent, from US$4.3 billion in 2014 (covering 3 months of imports) to US$7.5 billion in 2017 (covering 4.2 months of imports), buoyed by recovery in exports as production from new oil fields comes on stream in 2016-17. This target is both prudent and attainable, but could be jeopardized if commodity prices fail to recover or the anticipated increase in economic growth from 2016 sparks an unsustainable expansion of imports as happened during the previous boom.

There are also other important challenges to contend with in the attempt to strengthen the balance of payments position. First, Ghana's wide external current account deficit has inherent structural weaknesses, making one to think that the projected reduction in the current account deficit from 9.2 percent of GDP in 2014 to 4.9 percent in 2017 appears too optimistic. We hold this view because of the significant oil and gas industry-related imports as well as the continuing high consumer goods imports

that may come on stream during the program period. Although for the first quarter of 2015, the current account deficit narrowed to US$549.3 million from US$1.1 billion in the same period of 2014, the trade deficit worsened from US$215.1 million to US$446.2 million. In addition, the balance of payments registered a deficit of US$849.4 million during the first quarter of 2015, while the gross international reserve stood at US$4.8 billion, down from US$5.2 billion in the same period of 2014 (BoG, May 2015).

In 2014, the country met its gross external financing requirement mainly through reserve drawdowns and project loan disbursements. For 2015, one was expecting that the initial disbursement of part of the US$918 million ECF and other multilateral lender funding in the year will support the country's external financing needs. But, given the disappointing initial disbursement of the ECF, the country's reserve coverage would most likely continue to weaken, putting enormous pressure on the cedi. The balance of payments risks will also not be mitigated to any significant extent by the US$114.8 million of the ECF disbursed by the IMF. The Fund expects that an increase in oil exports and lower oil imports (because of domestic gas production) will spur the current account and support foreign reserves over the medium term, not recognizing the impact of the adverse terms of trade shocks for the country's main exports on the external accounts. Gold prices marginally lost ground in 2014 while cocoa prices moderately recovered. Gold prices slumped by 36% in 2014, crude oil by 28%, and cocoa beans and related products by 17% (Standard and Poor's, 2014) and the three commodities account for over 75 percent of Ghana's exports and are the mainstay of the country's economic growth. According to the revised 2015 budget, lower oil prices will lead to a loss of government revenues of about 2 percentage points of GDP, implying that if the slump in crude oil prices continues, then the country cannot bank its hopes in building fiscal and foreign exchange buffers based on oil production and exports. In addition, the fragile global financial conditions could adversely impact on the country's reserve accumulation, while the anticipated increase in the United States interest rates could lead to capital flow reversals.

Second, foreign direct investment and portfolio flows, the two key external financial account items, are confidence sensitive and could be at risk if the government is unable to convince investors of its commitment to long-term economic and fiscal reforms. Nonetheless, the high and rising inflation and the continuing depreciation of the cedi may tend to weaken confidence in the economy and consequently investment. Contrary to what some analysts believe therefore, one should not expect sufficient foreign direct investment and other capital flows to fund most of the anticipated large current account deficits in 2015 and 2016. As a result, the country may not be able to maintain the projected foreign exchange reserves envisaged under the Fund program.

Third, the policy of unbridled trade liberalization or more appropriately import liberalization has compelled Ghana, as a nation, to live virtually on imports. The increasing appetite for imports means that the demand for foreign currency especially the US dollar is growing exponentially, putting pressure on the cedi exchange rate, and a number of jobs are being lost. And with the value of the cedi depreciating on a daily basis, domestic prices of imports keep on rising with adverse implications for living conditions of Ghanaians with fixed incomes. While market forces are recognized as important in mediating economic exchanges, the state must retain the right and possibilities to manage economic issues in a strategic way to achieve national objectives. Economic policies must emphasize the centrality of adding value to natural resources and being able, as a country, to produce some of the basic necessities of life, such as food, water and clothing. The country cannot make any headway in reducing poverty and improving living conditions by living on imports.

This is where the government's transformation agenda, a central plank of which is the diversification of the economy's production and export base, becomes very important. First and foremost, macroeconomic stability will have to be established and entrenched in the country through the implementation of sound fiscal policies and the building of strong buffers and mechanisms to manage risks. The resulting low inflation, currency stability, and low interest rates will make capital more affordable for firms and reduce business risks. Second, investment in productive infrastructure, mainly energy and transport, needs to be

increased but at the same time innovatively financed to ensure fiscal sustainability. Third, government expenditure and tax policy should focus on realigning the incentive structure of the economy such that it would pay people more to engage in aggressive domestic production than relying on imports from abroad for distribution and trading. Indeed, without a thriving manufacturing sector, the country cannot pursue export-led growth nor succeed in diversifying its export base. The challenge of boosting national productivity and creating decent, well-paid jobs would also be more daunting if the manufacturing sector does not witness a turnaround from its current dismal fortunes.

4.6 Debt dynamics

There is a real concern relating to the downside risk of the country's debt dynamics and liquidity pressure in the short-term if the Fund program fails to successfully contain the fiscal deficit, stabilize the currency and address current impediments to higher economic growth. The deteriorating fiscal strength and the adverse debt dynamics fueled by high domestic interest rates and currency depreciation against the major international currencies are extremely disturbing. Without measures to smooth the amortization of the 2013 Eurobond, the 2023 bullet repayment may result in a breach of the indicative external debt service-ratio. The issuance of the 2014 Eurobond at the coupon rate of 8.125 percent could also lead to a breach in three consecutive years in the absence of measures to smooth the amortization profile. It thus appear that the government is trying to meet its total funding needs, mainly through increasing use of dollar-denominated bonds and domestic issuances as the refinancing tool. The government has also indicated its intent to consolidate and lengthen the duration of the country's debt profile as well as relaxing the restriction on nonresident participation in the short-term end of the domestic government debt market.

Moreover, the current financing conditions may be tighter and costly for the country. In its latest World Economic Outlook, the IMF advises sub-Saharan African countries, including Ghana, planning to issue Eurobonds in 2015 to put in place a contingency plan to forestall imminent shocks from exchange rate volatility (IMF, April 2015). This concern stems from what the Fund describes as "unusually large" exchange rate movements. Among the major currencies, the dollar has seen a major appreciation (reflecting major differences in monetary policy, with the USA expecting to exit the zero lower bound this year) and the Euro and the yen, a major depreciation. The expected hike in the value of the dollar and interest rates means that it will be more costly to borrow from foreign capital markets especially as the country's currency continues to depreciate against the dollar. This can also lead to a hold-back of huge foreign inflows to the country. Already, it is reported that foreign investors have reduced their holdings in Ghanaian securities by GH₵362 million in the first three months of 2015, making it the second consecutive time in six months that non-resident investors have cut their investments in the country. It is believed that the decline in foreign holdings of Ghanaian securities is due to the weakening investor appetite and loss of confidence for government's debt because of the lingering doubts about long-term macroeconomic stability and public financial sustainability (see Boah-Mensah and Ashiadey, 2015). This explains why the IMF has put emphasis on debt reduction as one of its key benchmarks. Limited fiscal and external buffers in the face of tighter United States dollar liquidity, economic headwinds and terms of trade shocks will also increase the risk for the adverse debt dynamics (Moody's, 2014).

In addition, the increased government liquidity risk emanating from the large gross borrowing requirements in the face of more difficult domestic and external funding conditions also poses serious challenges to fiscal consolidation and stability of the external accounts. In particular, the higher than the prevailing risk premia that the September 2014 Eurobond issuance added to the challenges of returning to the international markets ahead of the $530 million Eurobond maturing in 2017, notwithstanding the establishment of a Sinking Fund aimed at assisting with future debt repayments, is worrisome. On the domestic market, large domestic rollover needs and a front-loaded issuance calendar have driven interest rates to over 25% in the short-term Treasury-bill segment. The weighted average interbank rate has been above 23 percent while the average lending rates of banks have remained stable at 29 percent for

over a year now. Hence, the proposal to reduce the scope for central bank support in financing the fiscal deficit to zero over the medium term is unrealistic.

5 Recommendations

5.1. Review the key program targets to make them realistic

The IMF deal for Ghana may ease short-term fiscal and external financing pressures in the economy, but given the nature of the program, with its front-loaded fiscal consolidation and zero central bank financing of government, serious challenges could be faced over the medium term. First, the program envisages the fiscal deficit narrowing to 3.7 percent of GDP in 2017 from 9.4 percent in 2014. It is our view that the fiscal targets are too optimistic given the structural weaknesses of the country's public finance and the steep slowdown of economic growth, and should therefore be revised to give more space to the government to achieve them.

Second, Ghana's economic growth in 2014 reached its lowest level of 4.0 percent in 14 years amid high interest rates, a fast depreciating currency, low domestic demand, and a deepening energy crisis. The dollar value of the GDP shrunk from US$48.6 billion in 2013 to US$38.3 billion in 2014 (GSS, 2015), reflecting a drop in the size of the economy in 2014 by over US$10 billion due mainly to the exchange rate depreciation which saw the cedi decline in value by more than 30 percent against the dollar. Economic growth rate is projected to slow down for a fourth consecutive year in 2015 to 3.5 percent on the back of a severe energy crisis and the budget-tightening measures. Growth may rebound over the medium if the macroeconomic environment sees improvement, the additional oil and gas come on stream, and cost-effective solutions to address the energy crisis are found. Given that some of these growth-supporting factors are unlikely to happen at all or may happen at a later stage, the growth targets for 2016 and 2017 look too optimistic.

We support the strengthening of the independence of the central bank but the reduction of the bank's financing of government to zero in 2016 is unrealistic. The policy also dilutes completely the central bank's functions of being the government's bank and also the lender of last resort.

5.1 Strengthen public financial management

As the program has rightly recognized, to support and sustain the fiscal adjustment, measures to reform and strengthen financial management in the public sector are urgently needed. Indeed this was made clear in the 2013 PEFA assessment which revealed that significant financial management gaps in terms of credibility, predictability and control over budget execution exist in the public sector. The Auditor General strongly supported this view in his Report on the Public Accounts of Ghana's MDAs for the year ending 31 December 2013 when he stated as follows. "My report on MDAs for 2013 indicates continued infractions and financial indiscipline on the part of MDAs in acknowledging and observing legislative supremacy. Several irregularities have been highlighted in this report. The irregularities show the lack of probity and propriety or the extent of non-compliance with or deviation from and disregard for the tenets of laws, rules and regulations designed to secure the conduct of government financial business in an orderly and legal manner and as well preserve or improve the nation's wealth and resources.

The irregularities represent either losses that have been made by the nation through the impropriety or lack of probity in the actions and decisions of public officers or, on the other hand, the savings that could have been made, if public officials and public institutions had duly observed the public financial management framework put in place to guide their conduct and also safeguard national assets and resources".

Clearly, weak financial management in the public sector has been the seed of fiscal slippages and fiscal indiscipline in the country. There is therefore an urgent need to reform the financial management system in the public sector in order to maximize service delivery through efficient and effective use of the limited resources. The proposed PFM strategy to be submitted to Cabinet by August 2015 and draft bills to deal with the weaknesses in the existing PFM laws by December 2015 should be commended. The IFS wishes to make the following recommendations to support the government's decision. First, the strategy should aim at modernizing the system of financial management in the public sector by breaking away from the current regime of opaqueness, poor information, and weak accountability. It should lay the basis for a more effective corporate governance framework for the public sector. The key objectives of the strategy should be as follows:

- Modernize the system of financial management;
- Allow public sector officials to manage but, at the same time, be more accountable;
- Ensure timely provision of quality information;
- Eliminate waste and corruption in the use of public assets and resources.

Second, the Financial Administration Act (FAA) and its accompanying Regulations should be amended to include an approach to financial management that focuses on outputs and responsibilities, rather than the current rules-driven approach. The new Act should be part of a broader strategy for improving financial management in the public sector. It should focus on the basics of financial management, such as being done currently with the introduction of the GIFMIS, and appropriation control and accountability arrangements for the management of budgets. The new Act should strengthen the Loans Act, 1970 (Act 335) on the issue of borrowing and the issuing of guarantees. It should declare wasteful, fruitless, irregular, unbudgeted and over-expenditures as a financial misconduct in the public sector, and outline the procedures for taking disciplinary action against public officials guilty of such financial misconduct.

Third, the new Act should seek to separate clearly responsibilities in the public sector. It should declare that the political head of a ministry, i.e., the Minister, should be responsible for policy matters and outcomes, including seeking parliamentary approval and adoption of the ministry's budget. The head official, i.e., the Chief Director, should be responsible for implementation and outputs (service delivery). This approach will give support to the new performance orientation in the public sector which relies on a performance-driven system based on measurable outputs. The new Act should vest the following key responsibilities in Chief Directors and heads of public institutions.

a. The operation of basic financial management systems, including internal controls in ministries and entities under their control;
b. To ensure that ministries do not overspend their budgets;
c. To report on a monthly and annual basis, including the submission of annual financial statements three months after the end of a financial year, and
d. To publish annual reports in a prescribed format on the performance of ministries.

Chief Directors and Heads of Public Entities who are negligent and make no effort to comply with these responsibilities should be made to face strict disciplinary sanctions.

Fourth, the new Act should facilitate the move towards real program budgeting in government by requiring Parliament to vote by program (main division within a vote) rather than ministerial votes. The program budgeting process will require information on output per program and limit the powers of Chief Directors and Heads of Public Institutions to move funds between programs.

5.2 Control expenditure

There is a strong need in the short term for expenditure control. First, a serious action is required to deal with the wage bill since it has been a major cause of the government expenditure overruns. As a

temporary measure, the government must consider outsourcing the management of the payroll as part of the measures to rationalize the wage bill, given that numerous attempts to clean the payroll have proved unsuccessful. The outsourcing should be combined with regular audits of the system to maintain its integrity. Although the Inter-Ministerial Committee on Payroll is doing a fantastic job by suspending, validating and possibly restoring names of employees with zero bank accounts, introducing payroll database and payroll data, etc., all in an attempt to flush out all ghost names from the system, this is not the first time that such a comprehensive cleaning of the payroll has taken place. But, anytime the ghost names were expunged from the system, they resurfaced.

The problem with the public sector payroll management is both systemic and human. The system issues are currently being addressed with the implementation of GIFMIS and the new HRMS, new payroll system, and the electronic system payment voucher (E-SPV). The human problems have to do mainly with officials in the Controller and Accountant General's Department, the institution charged with the management of the payroll. We need not remind ourselves of what the CAGD did with the Minister of Finance letter of 12 June 2012 on the running of the payroll on the new IPPD3 ("Akatua" system) and the tussle between Soft Tribe (payroll system developer) and the CAGD on the utilization of the same IPPD3 which led to a loss of huge sums of money (see KPMG, 2012. The payroll management should therefore be outsourced to a private payroll management company for a short period after completion of the Inter-Ministerial Committee's work to ensure that all the cleaning exercises and reforms currently taking place gain root and the integrity and robustness of the system are firmly established.

Second, although the lack of basic systems of tracking and blocking unfunded spending at commitment stage has been cited as one major cause of the build-up of domestic arrears and the GIFMIS when completed would address this problem, it is strange that after paying GH₵7.1 billion as arrears between 2009 and 2012 and another GH₵5.3 billion in 2013-2014, arrears are still an issue over the medium term. If indeed these payments were arrears, then it is difficult to understand why economic growth slowed down considerably in 2013 and 2014. As a primary action, the IFS wishes to advice that an investigation should be conducted into the issue of arrears and similar claims paid between 2009 and 2014 to ascertain their genuineness. To promote transparency, details of the true and valid claims should be published by the Ministry of Finance after the investigation, and Parliament should be fully briefed on the government strategies to prevent arrears recurrence.

Third, the intention of the government to amend the laws protecting transfers to statutory funds to remove rigidities in the budget and create space for policy maneuver and ensure efficient allocation of budgetary resources is commendable.

5.3 Enhance domestic revenue mobilization

Domestic resource mobilization is at the crux of financing for sustainable development. But domestic resource mobilization is enhanced by sustained and equitable economic growth. Therefore, the need to promote productive activities that generate sustainable growth and an inclusive and sustainable income base for resource mobilization should be at the top of any reform agenda. Public resource mobilization has also grown significantly in recent years, yet resources still remain insufficient to meet sustainable development needs of the country. There are still large gaps in the country's capacity to raise more domestic revenue despite the recent reforms in tax policy and tax administration. The government needs to strengthen domestic governance and set out credible plans for strengthening the Ghana Revenue Authority and to combat tax avoidance, tax evasion and corruption at all levels. The tax laws and regulations should be simplified and strengthened to combat tax evasion while increased international tax cooperation can help to substantially reduce or eliminate illicit financial flows. Opportunities for tax avoidance can also be reduced through increased fairness and transparency of the tax system, including

by ensuring that all payments to government by large companies are fully transparent, improving the effectiveness of the tax system, including the broadening of the tax base and by making efforts to integrate the large informal sector into the formal economy. Government should also address the excessive tax incentives in the extractive industry, including concessions and royalty agreements.

The plethora of leakages arising from smuggling and foreign trade under-invoicing; bonded warehousing and free trade zones regimes; transit goods; weaknesses in excise tax and VAT (non-registration, under-declaration and categorization problems); and transfer pricing need to be plugged as a matter of urgency. The government's intention to do this is therefore a step in the right direction. In fact, special tax forces, comprising the police, army, private accountants and investigators, tax experts, etc., need to be established and deployed to monitor and report on the assessment of duties and taxes due and revenues collected from these sources. There is also a spate of tax exemptions and special permits which allow imports to be cleared without payment of duties, all of which have to be reviewed as indicated by the government. Assessment and collection of property taxes and land rents also need to be stepped up considerably.

5.4. Strengthen the inflation targeting framework

First, while many of the elements of a functioning inflation targeting regime are in place in the country, the current policy mix poses challenges. In moving forward, there is the need to generally strengthen the interest rate transmission channel by ensuring that there is an effective policy rate that provides a meaningful signal for expectations as well as a strong pass-through to market interest rates. Also, although important progress has been made in developing the monetary policy implementation framework, important challenges remain in the conduct of monetary operations. For an inflation targeting regime, liquidity management requires a clearer short-term focus to ensure stability and balance in the market for bank reserves, together with improved forecasts, and some adjustment of its instruments. In addition, improved coordination of fiscal and monetary policy will help improve liquidity management and hence, the implementation of monetary policy.

Second, to help strengthen the inflation targeting framework, the government has also committed to amend the Bank of Ghana Act to include a provision to limit Central Bank's lending to government. This new provision is expected to kick-off in 2016. Much as the recent large fiscal deficits were heavily monetized by the central bank, with obviously negative repercussions on price stability, care should be taken not to involve in policy overkill in trying to address this issue. One of the goals of central bank lending to government is to smooth out tax revenue fluctuations and thus assist the government in managing its liquidity. Taking away this support at a time when the domestic debt market is still developing could worsen the financing conditions faced by the government. It would also effectively transfer the lender-of-last resort function of the central bank to other domestic creditors, which could exacerbate the crowding out of the private sector. It is therefore necessary to proceed cautiously in implementing the zero-financing of government by the Central Bank as this can become very problematic.

5.5. Reform the civil service

We support the program in recognizing the need to implement a comprehensive reform of the civil service. This reform should however focus on employment and wage policy since the high government wage bill reflects structural lapses in these two areas. The objectives of the reform should be to link public sector pay to productivity, position, and qualification; maintain the competitiveness of public sector incomes relative to the private sector; and determine the optimal number of workers needed to efficiently deliver public services. The reform should have three main components: short- term measures to contain the wage bill, wage policy reform, and employment reform.

In the short-term, the wage bill can be contained and the size of the civil service reduced by combining attrition with a selective hiring freeze (as is currently the case); (ii) centralizing recruitment; (iii) cleaning and performing regular audits of the new payroll system to maintain its integrity; and (iv) avoiding across-the-board salary increases.

As part of the wage policy reform, the Single Spine Pay Structure has been implemented since 2010 after the government removed distortions in the then Ghana Universal Salary Structure and undertook an assessment of job content and the consequential placement of all public sector employees on the new salary structure. Moving forward, the Fair Wages Commission should adopt a systematic approach to wage setting.

The wage policy reform should also involve a consolidation of basic salaries, allowances and in-kind and non-monetary benefits into single remuneration packages for post levels in the civil service and sub-vented organizations. This single remuneration package should be applicable within 4-5 years, during which period the packages or salary bands will remain the same but will be adjusted annually to reflect inflation expectations. Under this single salary package structure, movement within a given salary package or band, i.e., movement from one notch to another within the same salary band, should be used to reward performance while movement from one salary band to another should be effected by promotion. Centralizing recruitment in the civil service is another measure that deserves a serious attention by the government.

The pay scale in the public sector should also be decompressed gradually to facilitate recruitment and retention of skilled personnel. In reforming the pay structure, the government needs to be mindful of how decompression will affect the average wage and the wage bill. To the extent possible, private sector wage comparators should be used in setting public wages for highly skilled personnel, but the exercise must take into account all aspects of compensation (including in-kind and nonmonetary benefits) and the greater job security in the public sector. International evidence suggests that public wages would still be competitive at about 80–90 percent of the private sector average. This would improve budgetary transparency and decision making while contributing to fairness in government compensation across sectors. Moreover, it would broaden the income and social security tax base. A tighter link between pay and performance will give workers an incentive to improve efficiency and productivity. Wage policy should be based on transparent rules and objective criteria for promotion.

The policy of net freeze on employment and non-replacement of departing public sector employees' in the public sector, except in education and health sectors, as a means of containing the wage bill may need to be reviewed. This is because the high public sector wages and salaries bill reflects structural lapses in recruitment and the wage policy itself. In the past, repeated wage overruns have emanated from serious weaknesses in payroll management and recruitment in sub-vented agencies. Control of the wage bill was lost because staffing and wage demands and negotiations occurred outside the budget process, and were not subject to budgetary constraints, policy priority objectives, productivity growth and trade-offs among competing spending needs. Second, the two big ministries, viz. education and health, that account for over 60.0 percent of the total MDAs wages and salaries are not affected by the net freeze on employment policy. By excluding education and health sectors, the net freeze on hiring policy still leaves room for further growth in payroll numbers in these two areas, which will not lead to a significant reduction in the total wage bill (IFS, 2014).

The decision of the government to undertake a functional review of the civil service to provide an objective basis for a plan and schedule for right-sizing as part of the employment reform is a laudable one. The government should also step up the civil service employment reform and the restructuring of sub-vented agencies that are deemed to be overstaffed. In addition to combining attrition with selective hiring freeze, there is the need to re-centralize recruitment in the Office of the Head of Civil Service; strengthen the computerization of staff and payroll control system of all MDAs, including the

implementation of corrective measures to improve data inaccuracies, robustness of controls, and enhancement of capacity for smooth operation; undertake annual audit of the personnel database. Sub-vented agencies that are no longer relevant to the government's objectives should be liquidated and those that need to be partially or fully commercialized should be instructed to do so within an agreed time frame. Savings from reductions of government employment could be used to gradually decompress salary scales and incorporate allowances in monetary pay (IFS, 2014).

It should be recognized that a number of factors are likely to contribute to the success of civil service employment reform after many earlier failures. In particular, a well-cleaned and managed payroll system will help gain control over the number of civil servants. Also, the government should strive to avoid shortcomings in past attempts at civil service reform. These include (i) the inability to tackle system-wide issues, such as public sector pay, rightsizing of public-sector agencies and human resource development; (ii) capacity constraint at managerial and professional levels; and (iii) fragmented and uncoordinated public sector modernization programs. Experience in other countries suggests that civil service reform should be part of the medium-term plan. Structural weaknesses in the civil service are best addressed over the medium term, even if that means lower savings in the short term. Integrating civil service reform into a larger context helps to clearly identify the costs of reform and ensure that they are not merely shifted from wages and salaries to another budget item.

5.6. Enhance performance culture in the public sector

The introduction of performance orientation in the public sector, through the signing of performance contracts by Chief Directors, to ensure that service delivery and public spending become more efficient is strongly supported. The signing of performance contracts should however be extended to all heads of public institutions and also directors in all public institutions should have similar agreements signed with their heads. To ensure that the performance contracts support good financial management, they should outline clearly the Chief Directors and heads of other public institutions responsibilities relating to budget control or fiduciary duties. The contracts should also contain provisions outlining frameworks for rewards and sanctions. The new HRMS should be supported by the implementation of a well-designed performance management and development system (PMDS) to give full effect to the institution of performance orientation and accountability in the public sector. The move towards the signing of performance contracts will complement the discharge of the key financial responsibilities of heads of public institutions.

5.7. Strengthen oversight of state-owned enterprises' financial operations

Government should also strengthen oversight of state-owned enterprises financial operations by systematically monitoring the SOEs and demanding reports that show that their financial risks are properly evaluated and mitigated. To this end, the capacity of the State Enterprises Commission (SEC) should be strengthened to enable it closely monitor performance contracts signed by wholly state-owned enterprises. Priority should be given to the four largest enterprises - Volta River Authority, Electricity Company of Ghana, Tema Oil Refinery, and Ghana Water Company Limited - that account for the bulk of the quasi-activities and pose substantial fiscal risks. Because the financial situation of these four SOEs critically depends on pricing, the reform of utility pricing should be pursued vigorously to allow for a move to full recovery of costs. In addition, transparency requirements, in the form of observance of codes of good governance, need to be enforced. The government should also ensure that the financial statements of the large SOEs be prepared every year without exception and be audited by reputable private firms that adhere to international standards.

5.8. Revive manufacturing activities to diversify exports

To help conserve foreign exchange and support the value of the cedi, moderate inflation, support economic growth and boost exports, and create jobs, the country's manufacturing sector needs to be revived. The country's unbridled trade liberalization policy also needs to be revisited, with the view to curbing certain imports. One major cause of the country's economic challenges is the over-reliance on the export of primary and unprocessed commodities (cocoa, gold, crude oil) which are subject to price fluctuations on the international market. At present, the available economic incentives favor importation rather than domestic production of goods. The country's exports have been hampered by increased competition in the domestic market and high production and distribution costs arising from high interest rates, obsolete equipment, inefficient infrastructural services and low productivity. As a result, practically everything is imported as the manufacturing sector has almost ground to a halt. The trade deficit has been growing as imports saturate the domestic markets and shops and as the country continues to export its natural resources in their raw form. There should be greater targeted support for industries with a vast export potential, such as agro-processing, clothing and pharmaceuticals. The success of these initiatives will bolster the performance of the external sector over the medium- to long-term and reduce the vulnerabilities arising from a perilous dependence on commodity exports. Some of these policies are outside the remit of the IMF, but must nonetheless be pursued since they are at the core of much-needed long-term sustainable solutions to the country's problems. In fact, the IMF itself has advised the government to also implement measures intended to diversify the economy to reduce vulnerabilities (see Daily Graphic, April 15, 2015).

Both tax policy and policy reforms in the business environment should be used to create an incentive structure that boosts domestic manufacturing and production for exports. To this end, a special levy should be imposed on several imported items. It should be mentioned that in 2010 when the duty on rice importation was reinstated, the importation of rice was drastically reduced which led the production of local rice to shoot up significantly. To support the revival of the manufacturing industry, the country needs policies and programs that reward domestic production and penalize imports that can easily and efficiently be produced locally. Such policies may include expanding business firms' access to credit and international (export) markets, reducing business risks and the soaring interest rates, creating a congenial business environment, and dealing with the energy crisis and transportation problems. In this regard, the government's industrial policy that aims at providing support for the land reform process and the enhancement of labor productivity through the application of new technologies is most welcomed.

6 Conclusion

Ghana's medium-term development prospects have been put at risk after two decades of strong and broadly inclusive growth, due to large fiscal and external imbalances in recent years which have led to a slowdown of economic growth. To address these imbalances and safeguard the bright medium term prospects of the economy, the government embarked on its homegrown economic and financial program, but policy slippages, exogenous shocks, rising interest costs, and acute electricity shortages undermined the effort. Recognizing the need for strong reforms to achieve fiscal consolidation and debt sustainability, the government approached the IMF for support which was granted in April 2015. The Fund's supported program aims to restore macroeconomic stability and sustain growth.

While the IMF program is a welcome deal and may ease the fiscal and external pressures, sticking to the program with its ambitious front-loaded fiscal consolidation, the central bank's tight monetary policy and zero financing of government will pose serious implementation challenges to the government. A number of the program targets and benchmarks, including the rate of fiscal deficit reduction and GDP growth appear too optimistic given the substantial short and medium-term downside risks the economy faces. The likely pressure that the 2016 elections may put on government spending may also work to

undermine the fiscal consolidation effort. Even with the discipline, political and social determination to implement the measures, the fiscal deficit targets and GDP growth projections set under the program will be difficult to achieve within such a short period of three years.

Our view is that, given the structural weaknesses of the country's public finance, the steep slowdown of economic growth resulting from the high cost of production, low aggregate demand and a deepening energy crisis, the fiscal deficit targets and GDP growth projections should be reviewed to make them more realistic. The reduction of the central bank's financing of government to zero from 2016 could be problematic. The policy also takes away the central bank's function as the lender of last resort and should therefore be reviewed. In addition, we propose the following measures to support those set under the IMF program.

1. Modernize the public financial management system and amend the Financial Administration Law to focus more on outputs and clearly outlining responsibilities of ministers and heads of ministries, departments and agencies;
2. Control expenditure by outsourcing the management of the public sector payroll; audit all arrears and claims to establish their genuineness; and amend the laws protecting transfers to statutory funds to remove rigidities in the budget;
3. Enhance domestic revenue mobilization by strengthening the GRA, making the tax system fair and transparent, and simplifying and strengthening the tax laws and regulation to combat tax evasion, tax avoidance and corruption;
4. Broaden the tax base by making efforts to integrate the large informal sector into the formal economy;
5. Address the issue of excessive tax incentives in the extractive industry, including concessions and royalty agreements;
6. Plug revenue leakages by strengthening the Ghana Revenue Authority with adequate resources;
7. Step up the collection of land rents and property taxes by resourcing and strengthening the Land Valuation Board to enable it compile statistics and valuation of properties in the country;
8. Strengthen the inflation targeting framework to make it work;
9. Continue the civil service reform by focusing on employment and wage policies;
10. Strengthen performance culture in the public sector and the oversight of state-owned enterprises' financial risks; and
11. Revive the manufacturing sector to diversify exports.

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