Review of the 2016 Budget

Press Release by the Institute for Fiscal Studies

November 24, 2015

1. Introduction

On November 5, this year, the Institute for Fiscal Studies (IFS) and Natural Resource Governance Institute (NRGI) organized a Budget Forum to discuss the economic challenges and risks confronting the country and the issues that needed to be addressed in the 2016 Budget. The Forum identified that, in the last three years, the government has not succeeded in improving the fortunes of the country despite setting ambitious targets every year. And despite the 2015 Budget Statement having a transformational agenda as its main theme, there is no evidence that the economy is being transformed. Real GDP growth has decelerated and, indeed, the projected real GDP growth of 4.1 percent this year will be the second lowest since 2000, driven by declines in the growth rate of all the key sectors of the economy. Growth of the agriculture sector has been decelerating, manufacturing activities have collapsed, having experienced three continuous years of decline, while mining and quarrying will contract this year, the first time in decades. The macroeconomic environment continues to be unstable. Inflation is on the rise, the cedi continues to depreciate, and interest rates still remain stubbornly high. The economy remains highly vulnerable to external shocks in the form of sustained currency depreciation, volatility in commodity prices, sudden stops in portfolio inflows into the domestic capital market for government securities, low levels of foreign currency reserves, and large share of foreign-currency denominated public sector debt. The public debt stock situation has worsened and the country now faces a high risk of debt distress and increased overall debt vulnerability. The country continues to face huge backlogs in critical infrastructure, especially transport infrastructure and energy supply. Corruption in the public sector is not only perceived to be on the increase but institutionalized.

2. Issues Identified by the IFS/NRGI Budget Forum to be addressed in the 2016 Budget

Given the current state of the economy, the IFS/NRGI Budget Forum identified the following issues to be addressed in the 2016 Budget:

- Pursue strong economic growth and a transformation agenda by establishing macroeconomic stability through sound policies and building of strong buffers and mechanisms to manage risks; undertake ambitious medium term adjustment to spur economic growth; recognize the centrality of the private sector in the growth and transformation process; undertake significant investment in critical infrastructure, especially transportation and energy supply; review the unbridled trade liberalization policy and provide support to industries with vast export potential such as agro-processing, clothing, pharmaceuticals, to improve the trade balance and generate more foreign exchange to support the currency;

- Strengthen fiscal consolidation through strong revenue mobilization and expenditure rationalization, including formalization of the informal sector, pursuing effective fiscal decentralization, and stemming the growth of public goods at the local level.
- Revise the Petroleum Revenue Management Act (PRMA) to support effective fiscal management. The PRMA is encouraging a scaling up of government spending; the capping of the Stabilization Fund is undermining the stabilization objective of the Act and the earmarking of petroleum revenues for priority areas has not helped advance development. These serve as a key motivation for the PRMA reforms going forward.
- Address the mounting public debt and sustainability issues through a well-grounded fiscal framework to anchor fiscal policy and guide it toward achieving the medium-term objectives; enhance domestic revenue mobilization; pursue a prudent, effective, and sound debt management strategy, including balancing the choice of financing sources and instruments, using borrowed funds to invest in projects with high social and private returns, and formulating an international debt workout mechanism;
- Strengthen fiscal and governance institutions by enhancing public financial management systems, Acts and Regulations, and strengthening the technical expertise and experience to efficiently and effectively manage the budget and external debt risks.
- Strengthen monetary policy by reviewing the inflation targeting framework which has become ineffective.
- Deepening the domestic capital market to expand the financing sources to government.
- Deal decisively with unemployment, especially unemployed youth and graduates through a comprehensive youth employment program (public works program, community development programs; public-private initiatives to engage the youth in agriculture and industry; establishment of business incubation centers).
- Deal with perceived corruption in the public sector because of its constraining impact on the economy and waste of public resources.

3. The 2016 Budget Response

The government tabled the 2016 Budget in Parliament on Friday, November 13, 2016. The key highlights of the Budget are as follows:

1. The macroeconomic targets for 2016 include the following:
    - Overall GDP growth of 5.4 percent;
    - Non-oil real GDP growth of 5.2 percent;
    - End-year inflation target of 10.1 percent;

- Overall budget deficit equivalent to 5.3 percent of GDP;
- Gross international reserves of not less than 3 months of import cover.

2. The government expects total revenue and grants to increase by GH₵5.8 billion or 18.2 percent in 2016, with domestic revenue increasing by GH₵6.3 billion or 20.7 percent while grants are projected to reduce by GH₵409 million or 20.3 percent. Tax revenue is expected to increase by GH₵3.7 billion through enhanced tax administration and tax compliance. The specific policies to effect the tax increases include the following:
   - Rollout of excise tax stamp project;
   - Implement measures to address revenue leakages;
   - Streamline the exemption policy;
   - Re-impose excise duty on cider beer; and
   - Review the income tax and VAT threshold bands.

   Non-tax revenue is projected to increase by GH₵2.5 billion or 51.7 percent, although the government plans to wean off commissions, agencies and authorities, including the Driver and Vehicle Licensing Authority (DVLA), Environmental Protection Agency (EPA) and Energy Commission from the central government and convert them into companies.

3. The government expects total expenditure (excluding import exemptions but including arrears clearance and tax returns) to increase by GH₵4.5 billion or 10.8 percent, with the increase spread across all the expenditure items.
   - Compensation of employees: GH₵1.7 billion or 13.9 percent;
   - Goods and services: GH₵680.4 million or 36.6 percent;
   - Interest payments : GH₵1.1 billion or 12.2 percent;
   - Transfers to government units: GH₵2.7 billion or 39.3 percent;
   - Capital expenditure: GH₵92.9 million or 1.4 percent;
   - Arrears clearance: GH₵81.8 million or 3.7 percent.

   The government intends to deal with the impact of the compensation of employees cost through payroll management, and strengthen the cash management system through the introduction of B-tracking, electronic travel cards, and electronic fuel cards in addition to the implementation of the Treasury Single Account.

4. The budget aims to reduce the fiscal deficit (on cash basis) to GH₵8.4 billion in 2016, reflecting a drop of GH₵1.3 billion or 13.7 percent from 2015. As a percentage of GDP, the deficit is projected to narrow to 5.3 percent in 2016 from 7.3 percent in 2015 in line with the IMF program. This deficit will be financed from both foreign and domestic sources in the following proportions:

- Foreign financing (net): GH₵3.4 billion or 40.5 percent
- Domestic financing (net): GH₵5.4 billion or 64.3 percent
- Deposits into the Ghana Petroleum Funds, Sinking Fund, and Contingency Fund will amount to GH₵400 million or 4.8 percent of the deficit financing.

5. The government plans to make more progress in 2016 with the implementation of a debt management strategy it has designed to provide more cost-efficient access to international and domestic capital markets. According to the government, significant progress has been made in ensuring that loans contracted for state-owned enterprises (SEOs) and ministries, departments and agencies (MDAs) for commercial projects are done with on-lending and escrow arrangements to ensure recovery. The use of sovereign guarantees will be limited while encouraging ring-fencing of SOEs' receivables for debt repayments, including utility payments. The Ministry of Finance will strengthen public debt management policy and operations by implementing an "Interest Rate Hedging Policy" through swap arrangements to allow for enhanced predictability of debt service.

6. The government plans to implement a public financial management (PFM) strategy that has been approved by Cabinet to further enhance efficiency, transparency, and accountability of the PFM systems, and also pass a PFM Bill into an Act in 2016 to provide a stronger regime for budget planning, execution and monitoring.

7. The government indicates in the 2016 Budget that, over the past three years it has established the Ghana Infrastructure Investment Fund (GIIF), developed a draft National Infrastructure Plan (NIP), and adopted public-private partnerships (PPPs) as the new approach to financing infrastructure development.

8. In 2016, the government plans to engage 100,000 youths in six different areas, including waste and sanitation, security services, community teaching assistance, community health assistance, youth in afforestation, and youth in apparel under the community improvement program. An additional 1,000 persons with disabilities are expected to be engaged. The government will also establish "Green House Capacity Building and Training Centers" to train farmers, the youth, women and agricultural graduates in commercial, modern greenhouse vegetable production in the country.

9. Government will also increase the number of beneficiaries under the Livelihood Empowerment against Poverty (LEAP) program from the current 116,000 households to 250,000 households in 2016 and also strengthen the institutional arrangements for social protection.

4. Observations on the 2016 Budget

The IFS has studied the 2016 Budget and is of the view that it has not addressed many of the issues and concerns raised at its Budget 2016 Forum. As we all know, it is through the budget that a government exercises the three key functions of economic policy, viz. allocative function, stabilization function and the distributive function. As such, the national budget should be able to identify the key challenges and risks confronting the economy, accurately diagnose their causes, and undertake the three functions of economic policy to provide corrective measures to address the challenges and thus influence the economy to make progress. Unfortunately, the 2016 Budget does not deal with the issues currently confronting the economy well enough. As many analysts have observed, the 2016 Budget looks like a mere fulfilment of a constitutional mandate than an instrument of economic policy and strategy to deal with the country's economic growth and development challenges.

First, the economy is experiencing a serious slowdown and instability at the macro level, caused by the twin deficits and weak monetary policy. The state of the economy now points to the need for a serious transformation. Unfortunately, and as we have pointed out several times, recent economic policies of the government are short of transformational ambition. The 2015 national Budget with its theme "Transformational Agenda: Securing the Bright Medium Term Prospects of the Economy", did not outline the policies and drivers of the economic transformation process and the expected outcomes. The result is the projected disastrous performance of the key sectors of the economy in 2015: agriculture sector is projected to grow at zero (0.04) percent; manufacturing sector will contract by 2.0 percent, making it three consecutive years of contraction; and the mining and quarrying sector will contract by 3.8 percent. Not only that but also inflation, exchange rate, interest rates and the current account deficit are all witnessing significant upswings, leading to serious instability at the macro level. This does not constitute economic transformation.

Second, on the issue of unemployment, the initiatives planned to be undertaken by the government are commendable but seem inadequate given the numbers of unemployed youth and graduates being touted about by some analysts and commentators. One would have expected the government to undertake a national survey of the unemployed youth and graduates to determine the actual numbers involved, their backgrounds and places of origin to help formulate appropriate training schemes and create employment opportunities to engage them.

Third, the government expects inflation to peak in the fourth quarter of this year and moderate towards the end-year target of 11.5 percent. The upside risks to inflation in the country are cost-push, including currency depreciation, interest rate hikes and the energy supply challenges. Without policies and strategies to address these factors, one wonders how the government intends to achieve convergence to its end of 2015 target of 11.5 percent and consequently move closer to the projected 10.1 percent in 2016.

Fourth, the 2016 Budget comes with a theme "Consolidating Progress towards a Brighter Medium Term". Like the 2015 Budget, the 2016 Budget does not explain the nature of the progress that it purports to consolidate other than the projected drop in the fiscal deficit. The Budget does not outline how innovation and technology-led productivity growth will be pursued to reverse the decline in agriculture, mining and quarrying, and manufacturing sectors; how to foster their inter-sectoral linkages to support economic growth; and how to achieve macroeconomic stability. With economic growth becoming stunted and the macro situation deteriorating, and no clear policies and strategies outlined to address these challenges, it is hard to see how the macroeconomic targets set for 2016 will be achieved.

Fifth, the government expects revenue to rise by 18.2 percent or 1.4% of GDP from 22.6% in 2015 (excluding the impact of import exemptions, which are now included as a memo item). Nontax revenue is projected to increase by a whopping 51.7 percent from GH₵4.7 billion in 2015 to GH₵7.2 billion in 2016 even though the commissions, agencies and authorities that generate the bulk of these revenue from fees, fines, and charges have been slated to be weaned off the central government and be converted into companies. Given the constant revenue shortages, the government was expected to come out with a clear and comprehensive plan to significantly enhance domestic revenue generation beyond the plugging of leakages, limiting of exemptions, imposition of new excise duties and revisions of the income tax regime to bring it in line with international practices.

Sixth, conspicuously missing from the 2016 Budget are plans to mitigate the impact of possible swings in oil prices. One of the main causes of the revenue shortfall experienced this year is the falling oil prices. Total oil revenues for fiscal year 2015 dropped by a whopping 58 percent, from GH₵4.2 billion to GH¢1.8 billion. Apart from the direct impact on oil revenues, the decline in oil prices also impacted negatively on revenues from petroleum taxes announced in the 2015 Budget, and indeed the fiscal deficit for 2015 was revised upwards to 7.3 percent of GDP from the original target of 6.5 percent of GDP mainly as a result of the loss in oil revenue. As at end–September 2015, GH₵1.2 billion representing 66.7 percent of targeted revenue had been realized. Based on a revised benchmark price of US$53.05 per barrel, a total of GH₵2.0 billion (equivalent to 1.3 percent of GDP) is projected to be received in 2016 as petroleum revenue. The 2016 petroleum revenue target is just GH₵200 million more than the target in 2015, due to the continuing low oil prices. With oil prices still experiencing volatilities and some analysts predicting that oil prices may drop to around US$20.00 per barrel, one would have expected the government to come out with clearly spelt out plans to mitigate the effects of the oil price fall in 2016, but unfortunately there was nothing. Meanwhile, the country's partners in the oil industry, viz. Tullow and Kosmos have all hedged against oil price volatilities until 2018.

Seventh, there is no indication in the 2016 Budget of a major reform of the PRMA going forward even though and, as some analysts have observed, the Act has proved ineffective in controlling government spending because as petroleum revenue rises it encourages government spending to go up through the benchmark revenue calculation. The Act has also been ineffective in managing oil revenue volatility because of the limited effectiveness of the Ghana Stabilization Fund. This arises mainly from the decision of the government to cap the GSF in response to the country's increasing debt-finance and contingency purposes. And although petroleum revenues have been directed towards priority areas, including infrastructure provision, agriculture modernization, debt-repayment, capacity building, etc., the overall share of revenues going to these areas has not increased. Meanwhile, non-oil revenues are being directed to fund recurrent expenditure, such as wages and salaries, interest payments, and subsidies to government units. This suggests that the use of petroleum revenues should be guided by development priorities and there is the need to avoid spreading oil revenues thinly over so many projects. There also remains a huge gap in transparency in the PRMA in terms of oil revenues that are now directed to the Sinking Fund, Ghana Investment Fund and the Contingency Fund which are not subjected to the same level of oversight as those revenues transferred to the Ghana Petroleum Funds and the Consolidated Fund.

Eighth, the government expects total expenditure (excluding cost of import exemptions and arrears clearance) to increase by 10.9 percent in 2016 from 2015. Compensation of employees is expected to increase by 14 percent, interest payments by 12.2 percent, and transfers to government units (subsidies) by 39.3 percent. These three expenditure items together will consume 93.8 percent of the projected domestic revenue in 2016, leaving only 6.2 percent to cover goods and services, the much needed capital expenditure, and payment of arrears. This may put pressure on the deficit target of 5.3 percent.

Compensation of employees is still very high, accounting for more than 30 percent of the total government expenditure and arrears clearance in 2015 and 2016. Compensation of employees is estimated at GH₵14.0 billion or 8.9 percent of GDP in 2016 from GH₵12.3 billion or 9.2 percent of GDP in 2015. Yet, the Budget does not outline a wage policy reform that will contain wages and salaries in the medium term and/or link the growing compensation of employees with productivity so that while cost increases on one hand there is a commensurate increase in the services the expenditure buys. The only wage policy currently in place is the net freeze on employment and non-replacement of departing employees in over-staffed areas, except in education and health, which is inadequate and ineffective.

The IFS was expecting to see how expenditure is going to be rationalized and contained in 2016 and the medium term, in the face of the increasing wages and salaries costs and interest payments and without cutting the much needed capital spending, especially spending on critical infrastructure in the transport and energy sectors. Unfortunately, the budget for Roads and Highways in 2016 has been cut by 33 percent while the budget for Local Government has been increased by 108 percent, and that for the Office of Government Machinery by 58 percent. Increased capital spending is required to remove backlogs in infrastructure and their constraining effects on economic growth. The proposal to realign transfers to other government units with the budgets of their respective ministries is supported as this will help reduce significantly the rigidity in the budget and create more room for policy maneuver.

Ninth, it is very worrisome that a total of GH₵10.4 billion has been allocated for the payment of interest on public debt in 2016, after paying GH₵9.3 billion in 2015. This will bring to a total of GH₵31.3 billion of interest payments in 2013-2016. The allocation to interest payments in 2016 is equal to 28.8 percent of the projected domestic revenue in the year, 24.1 percent of total expenditure, and 57.1 percent more than the projected capital expenditure which is at the center of economic growth and development. This points to the need to slow down public borrowing unless such debts are used to finance projects that can generate income within a reasonable period to pay off the debts. The decision to implement an interest rate hedging to allow for enhanced predictability of debt service is long overdue.

Tenth, the provision of GH₵2.9 billion for arrears payment in 2016 is puzzling because one does not know where these arrears are coming from after a total of GH₵7.4 billion was paid as arrears in 2013-2015 and GH₵7.1 billion in 2009-2012. The arrears provision in the 2016 Budget appears to be an attempt to reduce expenditure this year in order to meet the fiscal target set by the IMF program by underpaying or deferring some payments relating to wages and salaries, social contributions and grants to some government units and statutory funds. In any case, how does this huge provision for arrears comply with the Fund's performance criteria of continuous non-accumulation of new payment arrears?

Eleventh, the budget aims to narrow the deficit to 5.3% of GDP (cash basis) in 2016 from a projected 7.3 percent this year, in line with the IMF program. This is another area of the budget where the IFS has a major difficulty. The 2016 budget and fiscal data for September 2015 show continued commitment to fiscal consolidation, but as explained earlier there is greater reliance on revenue than expenditure measures, making the consolidation more challenging in 2016 if growth slows down and/or oil and gas production at the TEN field is delayed, or elections make public spending uncontrollable.

Besides, it has never happened in this country, apart from 2004, where the fiscal deficit is reduced in an election year. Spending strictly within the planned budget in an election year has been a challenge to governments in Ghana since the return to multi-party democracy in 1992 and there is nothing to suggest that 2016 will be an exception. We are therefore inclined to believe that the narrowing of the deficit in the 2016 Budget will be a challenge. In our view, the fiscal deficit will not narrow in 2016 due to the uncertainties around oil and non-tax revenues, and more importantly the challenges of consolidating expenditure in an election year.

Twelfth, financing the deficit is also likely to be challenging and expensive. The Budget assumes continuous borrowing from both foreign and domestic sources. Net foreign financing of the deficit is estimated at GH₵3.4 billion in 2016. In actual fact, a total of GH₵7.1 billion is projected to be borrowed from foreign sources in 2016, of which GH₵3.7 billion will be used to amortize maturing debt. The foreign borrowing also includes an issue of a non-concessional GH₵3.0 billion (USD750 million) Eurobond at a time when the financing conditions of the international market have become tighter and costly for the country. Ghana paid 10.75 percent to issue a 15-year USD1.0 billion Eurobond in October, despite the World Bank's partial guarantee.

Contrary to the government's position on using foreign debt to lengthen maturities and smoothen the public debt profile, the Budget indicates a return to the domestic market to largely finance the deficit. Net domestic financing of the 2016 Budget deficit is estimated at GH₵5.4 billion compared to the net foreign financing of GH₵3.4 billion. The planned domestic issuance, equal to 3.4 percent of GDP and unchanged from 2015, suggests that domestic borrowing costs will remain high in 2016 (short-maturity Treasury bills currently yield around 25 percent), complicating the public debt-service costs.

Thirteenth, public debt service-to-revenue and public debt-service to exports are not only on a rapidly increasing path but have breached their indicative long term thresholds. The IMF predicts that public debt-GPD ratio may exceed 72 percent by the end of the year. According to Bank of Ghana, the total public-debt GDP ratio also reached over 72 percent in June this year, with external debt posting 45.3 percent of GDP. The country's debt structure has also deteriorated, reflecting increased non-concessional external financing and short-dated domestic securities. High domestic yields and a sharply weaker exchange rate have pushed up borrowing costs, with interest payments accounting for more than a third of government revenue. The worrisome aspect of the increased public debt is that the debt is increasingly financing recurrent expenditure with no idea of where income to repay the debt will come from on maturity. Government capital expenditure as a percentage of GDP is on a sharp decline while public debt-GDP ratio is on the ascendancy.

Finally, there are a number of other observations on the 2016 Budget, including the following:

- A number of key programs and projects are misplaced in the budget document. For instance, the Ministry of Local Government and Rural Development lists construction of senior high school assembly hall, dry-farming, and urban afforestation as part of the projects it will undertake in 2016. The Ministry of Trade and Industry also mentions the construction of water closets, stadium, market, and assembly hall in 2016. Are these projects not the core responsibilities of other ministries? And were budgets not provided for by the responsible ministries?

- A number of projects that were slated to be implemented in 2015 for which budgets were allocated have also resurfaced in the 2016 Budget as new projects without any explanation. Ten MDAs have a number of projects mentioned in previous years' budgets reported in the 2016 budgets as new projects without any explanation. Meanwhile only three of the 10 MDAs have their budgets reduced in 2016.

The Ministry of Roads and Highways presents conflicting reports on the stages of completion of a number of road projects. The affected road projects include the following: Buipe-Tamale, Fufilso-Sawla, Tarkwa-Bogoso-Anyamfuri, Agona Junction-Elubo, Burma Camp and Giffard roads (Accra), and Sunyani road (Kumasi). For instance, the Agona Junction-Elubo road was reported as 58 percent complete by September 2014 in the 2015 Budget, but in the 2016 Budget the project is reported as 11 percent complete by end-2014 and will be 94 percent complete by end-2015.

- Like the 2015 Budget, the 2016 Budget is purported to have been prepared on program-basis. Yes, one can see the lists of programs being implemented by the MDAs in the Budget document, but not a single one of these programs is costed, making it difficult to establish how much it will require to implement each program. A fundamental requirement for program-based budgeting is that each program of a given institution has to be costed and all the programs presented to Parliament for approval. This means that when Parliament sits to approve a budget for an MDA, it does so for each program of the MDA and not as a bulk allocation for the organization. This is required to enable expenditures (costs) to be linked to output and outcomes, thus facilitating monitoring, accountability, and transparency in budget execution. Unfortunately, the 2016 Budget, like the 2015 Budget, does not present the costs of the MDAs' programs for Parliamentary approval, which is a major shortcoming in the budget preparation.

5. Conclusion

In conclusion, the IFS wishes to submit that the 2016 Budget is uninspiring. It is lacking in concrete economic policies and strategies to transform the ailing economy, establish macroeconomic stability and credible fiscal consolidation. The projected decline in the fiscal deficit will not be achieved due to uncertainties surrounding the revenue assumptions and difficulties in containing expenditure. Even if the deficit target is achieved, it may happen at the cost of a substantial build-up of arrears and a sharp decline in capital spending. Government will continue to borrow to increase the public debt stock and worsen its sustainability implications. Initiatives proposed in the budget to deal with unemployment are grossly inadequate, while the budget does not provide a comprehensive strategy to deal with perceived corruption in the public sector. In the view of IFS, the 2016 Budget in its current form cannot address all the critical economic challenges and risks currently confronting the country.