INSTITUTE FOR FISCAL STUDIES

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A Review of Ghana's 2017 Budget

1.0 INTRODUCTION

Ghana's 2017 Budget has been prepared at a time the economy is facing serious fiscal and macroeconomic difficulties. The fiscal deficit, which declined to 6.3% of GDP in 2015 from 10.2% of GDP in 2014, increased to 8.7% in 2016 despite the Extended Credit Facility-supported program the country is implementing under the auspices of the IMF. As a result, total public debt, which had been targeted to decrease, rather increased to 73% of GDP at the end of 2016, making the fiscal consolidation process the government has been pursuing appear derailed. The macroeconomic environment, which showed signs of improvement in 2016 following three years of high instability, also begun to deteriorate again, with a sharp depreciation of the cedi in early 2017. Real GDP growth, which has seen a sharp declining trend since 2013, dropped further to 3.6% in 2016, the lowest since 1994.

Against this backdrop, and in line with the NPP Government's Manifesto, which is captioned *"Change: An Agenda for Jobs,"* the 2017 Budget has as its theme, "*Sowing the Seeds for Growth and Jobs."* In general, the key policy objectives underpinning the theme include the following:

- Restoring macroeconomic stability and fiscal sustainability;
- Improving the business climate;
- Stimulating agriculture and manufacturing;
- Improving infrastructure; and
- Making senior high school education free.

2.0 THE 2017 BUDGET POLICY INITIATIVES

The budget introduces a number of policy initiatives to address the challenges confronting the country, grow the economy and create the much-needed jobs. Many of the key policy priorities, which the IFS has also identified as deserving attention by the government, include the following:

2.1 Economic Growth and Job Creation

As the budget theme indicates, growth is at the center of the government's agenda, and many of the policies announced have growth objectives, which are necessary to create jobs and alleviate poverty. These include tax stimulus measures, Planting for Food and Jobs campaign, provision of agricultural inputs and equipment, small businesses development, stimulus package for distressed industries, One Village-One Dam, and One District-One Factory initiatives.

2.2 Infrastructure

The budget announces an Infrastructure for Poverty Eradication Program (IPEP), a decentralized infrastructure development program that will target districts and constituencies. Projects planned under this program include One Village-One Dam, Water for All projects and sanitation projects. These projects are to be funded partly from an allocation of US$1.0 million to each constituency per year. A Zongo Development Fund, intended to provide critical infrastructure in the country's Zongos, is also to be established and funded separately.

2.3 Fiscal Consolidation and Macroeconomic Stability

The budget recognizes the burden that revenue earmarking for statutory funds currently places on the public purse by limiting fiscal space for discretionary spending. It therefore proposes an aggregate cap of 25% of tax revenues for all earmarked funds to allow a realignment of budget revenues to fund other government priorities. The budget appropriately regards restoration and sustenance of macroeconomic stability as a priority. This is to be achieved through enhanced fiscal and monetary discipline, and financial stability. The budget indicates a strong intention to achieve debt sustainability. To this end, it proposes to cut the fiscal deficit in 2017-19 and improve debt management through various initiatives, including lengthening the maturity profile of the debt stock and reducing risk/cost factors.

2.4 Free Senior High School

A major social intervention program in the budget is free public senior high school (SHS), including technical and vocational institutes. The objective of this program is to increase access to education at pre-university level. The program, which will commence in September this year, is limited to new entrants only and also includes free meals for students.

2.5 Capital Market Development

Ghana's capital market can be a source of long-term financing for both government and firms if well developed, leading to reduced foreign borrowing. However, as the budget recognizes, the market is failing to fulfil its potential due to poor depth and liquidity, among other challenges. A raft of measures have been proposed to address these problems.

2.6 Corruption

A number of initiatives have been spelt out in the budget to tackle corruption. These include continuing the implementation of the National Anti-Corruption Action Plan, establishment of the Office of Special Prosecutor and other institutional and legislative reforms to fight corruption, and strictly enforcing the relevant provisions in the Public Financial Management (PFM) and Public Procurement Authority (PPA) Acts, among others.

3.0 IFS REVIEW OF THE 2017 BUDGET

In keeping with its tradition, the IFS has reviewed the 2017 Budget and has the following views and comments on it:

3.1 Economic Growth and Job-Creation

First, the projected economic growth (oil-inclusive) of 6.3% for 2017 is encouraging as this would mark a turnaround in the economy after recent years of declining growth. However, the main driver of this growth is the projected additional oil production from new oil fields that are coming on stream, whereas non-oil growth is projected at 4.6%, the same rate as in 2016. The challenge here is that if for some reason the projected oil output does not fully materialize, then the projected GDP growth may not be achieved. Oil output therefore represents a major downside risk to the projected GDP growth.

Second, growth is intertwined with transformation of the economy from its colonial structure of high dependence on primary commodity exports and finished imports. While some of the budget's policy initiatives will contribute to this goal, a more elaborate articulation of an economic transformation agenda is missing. A critical element of economic transformation is ensuring balanced growth through revamping the agriculture and manufacturing sectors. We note that the budget intends to boost these sectors through various support mechanisms, including (a) Planting for Food and Jobs Campaign (b) Irrigation under the One Village-One Dam initiative and (c) Industrialization under the One District-One Factory initiative. Notwithstanding these planned interventions, the targets for economic growth in these sectors are disappointing, with agriculture and manufacturing projected to grow by only 3.5% and 2.6%, respectively, in 2017, and by an average of 3.9% and 4.0%, respectively, during 2017-19. These low growth projections raise questions about whether the initiatives planned for these sectors would be of sufficient scale to generate enough jobs to deal with the unemployment challenge facing the country. In fact, the possible effect of the projected low growth in agriculture and manufacturing is that job creation may be subdued.

3.2 Infrastructure

The infrastructure initiatives outlined in the budget are laudable, especially as they intend to bring infrastructure right to the doorsteps of communities, but are not enough. A by-product of the projects will be job creation that could help stem rural-urban migration and its attendant social and economic problems. Our hope is that they would be sufficiently funded and well-managed so as to bring tangible benefits to otherwise deprived communities. A burning issue which is not sufficiently addressed in the budget is energy supply, which continues to be in a somewhat precarious state. Much was said in the budget about boosting installed electricity generation capacity, but there was conspicuous silence on how the problem of fuel insecurity, which appears to be the most pressing challenge in the sector at present, is going to be resolved.

3.3 Fiscal Sustainability and Macroeconomic Stability

Fiscal discipline and sustainability, the most critical ingredients of macroeconomic stability, have long eluded the country. The IFS has identified the high level of rigidities in the budget as a major underlying cause of Ghana's fiscal problems, as it holds back efforts to achieve fiscal consolidation and sustainability. Together with wages and salaries, and debt service, transfers to earmarked funds have consumed much of the fiscal space, leaving no room for other priority spending. This led the IFS to call for a moratorium on the creation of earmarked funds, pending a critical review of the existing ones. We therefore think that it is in order that the budget has capped transfers to earmarked funds at 25% of tax revenue, pending a review of the existing relevant legislation so as to break the cycle of rigidities in the budget.

The IFS is pleased that the budget aims to restore fiscal consolidation, which sharply derailed in 2016, by targeting a lower cash fiscal deficit of 6.5% of GDP, compared with 8.7% for 2016. Equally encouraging is the intention to sustain consolidation by cutting the deficit progressively to 3.0% of GDP by 2019 (a target that was originally set for 2018). We believe, however, that a lower fiscal deficit (stronger fiscal consolidation) could have been targeted by directing the earmarked funds above the proposed cap to fund some of the existing or traditional expenditure items, instead of directing them to fund new expenditure items brought on board by the new initiatives. This would have helped to minimize borrowing, which has been budgeted at

GH¢16.75 billion in 2017 (GH¢12.09 billion in domestic borrowing and GH¢4.66 billion in international borrowing).

There are, however, serious risks to the budget's fiscal consolidation agenda. On the revenue side, given the wide range of tax reliefs being granted, and the fact that nominal income, to which most of the taxes are related, is projected to increase by a much lower rate of about 20%, the projected increase in taxes by 33.6% appears to be on the high side (although we recognize that strengthened tax administration, the planned reduction in exemptions (which is projected to rake in an additional GH¢1 billion in international trade taxes) and stricter enforcement would boost the tax effort). Even with this projected large increase in tax revenue, Ghana's tax-to-GDP ratio will only be 16.9% of GDP, which is low by middle-income country standards (of about 22%) and shows that there is still room to increase the tax effort. The IFS has proposed additional measures, beyond reducing tax exemptions, for mobilizing resources. These include broadening the tax base, especially to cover the informal sector (where we suggested new initiatives), strengthening tax administration through modernization and reinforced supervision, reinforcing tax compliance, and checking tax fraud, including by setting up relevant courts to deal with perpetrators.

On the expenditure side, total outlay (including arrears clearance) is projected to increase moderately by 13.7%. This moderate increase is to be viewed against the background of the proposal to cap allocation to earmarked funds at 25% of tax revenue and also to pay up to 20% of arrears while awaiting the outcome of a special audit. Capital expenditure is being slashed by 7.2% compared to last year's figure. Although last year's capital budget was overrun, the allocation for 2017 is disappointingly low, only 3.5% of GDP (compared to interest payments of 6.9% of GDP). Even for 2018 and 2019, capital spending will still be only 3.6% of GDP in each year. We, however, recognize that the capital spending line in the budget may not fully capture total investment spending, since other spending lines, such as allocations to the earmarked funds, may also involve some investment spending.

On structural fiscal measures, the IFS urges the government to apply the provisions of the new Public Financial Management Act (PFMA) strictly, as it has pledged to do, to enhance fiscal discipline. The decision to form a Fiscal Council (FC) that will set fiscal policy anchors and monitor them is also well-directed at entrenching fiscal discipline. The FC is akin to the Parliamentary Budget Office (PBO) that we—together with others—have recommended together with the adoption of some kind of fiscal policy rule to be embedded in a fiscal responsibility law, which are also components of the budget initiative. It deserves noting, however, that the FC in and of itself will not ensure fiscal discipline if other measures such as strong enforcement of the PFMA are not pursued.

Relative macroeconomic stability is expected to be achieved in 2017, with inflation projected to fall to 11.2% by year-end and international reserves to stabilize at 3 months of imports in 2017 and 3.5 months on average during 2017-19. Compared with the 15.4% recorded for 2016, the inflation projection would appear realistic. However, given that as at end-January, inflation had declined sharply to 13.3%, the target of 11.2% for end-2017 appears insufficiently ambitious. In fact, the country has for a long time been shifting the goal posts for achieving single-digit inflation (or the Bank of Ghana target of 8+/-2%), and it is the IFS' view that the budget should have aimed at achieving single-digit inflation by the close of 2017.

Although the international reserve levels being targeted appear to be adequate, the bigger problem, however, is the depreciation of the cedi. The cedi-dollar rate has dropped from GH 1.88 in December 2012 to GH 4.60 on March 10, this year, with no sign of abating. Very surprisingly, the budget does not provide measures to address the sharp depreciation of the cedi, which is likely to have widespread macroeconomic effects. Equally disturbing are the high interest rates and the high cost of credit to businesses.

3.4 Debt

It has to be pointed out that the measures planned to manage the public debt will only provide temporary relief to the budget in terms of reduced debt servicing. These measures in and of themselves will not diminish the debt stock. The surest way to place the debt on a sustainable path is to reduce the rate of debt accumulation through sustained fiscal consolidation. That is why we have urged a stronger fiscal adjustment effort to significantly reduce the rate of borrowing and thus the rate of debt build-up. It is also important that any further debt accumulation, which is inevitable—just as fiscal deficits are—is applied to high-economic-return projects that will foster growth and thereby reduce the debt-to-GDP ratio.

3.5 Capital Market Development

The IFS welcomes the idea of developing the local capital market. Our concern, however, is that the proposed measures are skewed towards the stock market, with little said about improving the debt market to facilitate access to long-term credit for both the public and private sectors. The IFS encourages the government to take steps to accelerate the use of longer-tenor instruments to mobilize domestic funds to finance the deficit. This will curb foreign borrowing and the associated exchange rate risk. It will also set critical benchmarks to enable the private sector also issue long-term bonds for their financing needs.

3.6 Free Senior High School

In principle, the IFS supports the free public Senior High School (SHS) policy, as it will not only contribute to the country's human capital development but also bring financial relief to many poor parents. It is our view, however, that rolling out the free SHS policy at this time will put a serious strain on the public finances at a time when fiscal consolidation is required to restore macroeconomic stability and support growth. It is also not clear whether the GH¢400 million provided to fund the policy in 2017/18 will be sufficient to cover both the direct and incidental costs of the policy, including the expected jump in enrolment. Currently, less than 70% of the 400,000 or so pupils who complete Junior High School (JHS) annually enroll in SHS, but this ratio could conceivably rise to close to 100% under free and compulsory SHS. Meanwhile, no mention is made of additional staff, learning and teaching materials, and classrooms that will be needed to support the expected increase in enrolment. The cost of the policy (excluding normal inflation) will also increase sharply in the second and third years as additional student batches are covered, with possible long-term increases as gross enrolment swells. These challenges indicate that unless a dramatic fiscal turnaround occurs, the free public SHS will be at risk of being poorly funded, as has happened to the free basic education program, with quality of education likely to be a casualty.

3.7 Corruption

The budget's proposals represent concerted actions to fight corruption, and the IFS hopes that the government will follow them through. The traditional government-monitoring institutions, including CHRAJ, EOCO and the Auditor General, should be strengthened and resourced to carry out their mandates effectively. Passage of the Right to Information legislation must also be prioritized, as it will advance the anti-corruption agenda. It is important also to signal a high cost of corruption by implementing surcharges against offenders and prosecuting them in the law courts.

4.0 CONCLUSION

No doubt the 2017 Budget contains a number of policy initiatives capable of delivering the overarching goal of "sowing the seeds for growth and jobs." The critical issue here is that the government is desirous of achieving this goal in a very rapid manner, yet the prevailing economic conditions do not support the pursuance of this ambition in such a rushed manner. First, weak infrastructure has become a key factor limiting agricultural and industrial growth in the country. The country's transport infrastructure development is inadequate, with the share of paved and motorable roads remaining low. The country is experiencing a power crisis with costly and unreliable electricity supply. Second, fiscal consolidation is yet to be achieved, restoring macroeconomic stability seems to be an illusion and achieving debt sustainability appears to be far away. Economic growth and job creation on a sustainable basis cannot be achieved without first providing the preconditions, i.e., addressing the infrastructure challenges, achieving fiscal consolidation, and restoring macroeconomic stability. Otherwise, the approach would be like building a house on a weak or non-existent foundation.

The government's commitment to implement growth-enhancing reforms and generate jobs has to be carried out in a fiscally sustainable manner and under conditions of macroeconomic stability. To help improve the business environment for job creation, the government must act, through fiscal management, to restore the confidence of the market. To successfully grow the economy, create jobs, increase incomes and reduce poverty will require a comprehensive planning and packaging of programs and projects; developing a proper implementation strategy and right sequencing of programs and projects; forging right coordination among the levels of government and relevant institutions; and establishing discipline in execution. The government should also ensure that the preconditions for take-off, including adequate funding, are all in place. Above all, the government must ensure that the processes are all-inclusive.

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