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# **GOVERNMENT EXPENDITURE ARREARS IN GHANA: TRENDS, CAUSES AND MANAGEMENT**



## **Government Expenditure Arrears in Ghana:** Trends, Causes and Management

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## Abstract

Government expenditure arrears have reached significant proportions in recent years, and their clearance has contributed to the growth in public expenditure, deficits and debt. This paper tracks the arrears problem, and examines its causes and management. It finds that the lack of a clear and uniform definition of expenditure arrears in the public accounts system, and the consequent resort to ad hoc definitions, makes arrears data liable to understatement or overstatement and undermines comparisons across time. Nevertheless, arrears are shown to have persisted and increased sharply since 2008 to become a significant fiscal burden. The main causes are underlying weaknesses in the public financial management system, which encompass gaps in the legal and regulatory regime, shortcomings in budget planning and execution, and weak support and oversight by political authorities. The paper recommends comprehensive reform in all these areas, including adopting a fixed legal or operational definition of arrears, to minimize the occurrence of the problem.

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## 1.0 Introduction

When faced with liquidity shortfalls, governments sometimes fail to make prompt payments on their due obligations, giving rise to arrears. Reflecting good financial management practices, these arrears should often be settled once the government's cash flow normalizes or improves. That way, the arrears are temporarily incurred to deal with the government's unexpected financial difficulties and would not tend to be recurring or increasing.

However, the recurrence of arrears is a common problem plaguing many governments' fiscal operations. A survey of 140 International Monetary Fund (IMF)-supported programs between 1999 and 2012 by Flynn and Pessoa (2014) found that 95 percent contained arrears-related structural benchmarks or performance criteria. These sought to ensure that the affected governments, which typically were faced with large or recurring arrears, cleared their arrears and took steps to prevent new accumulation.

The accumulation of arrears has several unwanted consequences on the government, creditors and the economy. Whenever the government accumulates arrears, it is more or less compelling the rest of the economy to finance expenditure on its behalf for which it has no ready money to pay. This "forced financing" of the government by private economic agents affects the allocation and distribution of the economy's resources in a way that ultimately may not be efficient (Diamond and Schiller, 1993). It can also have macroeconomic repercussions, such as reduced economic growth, since delayed payments may compel creditors (wage earners or companies, say) to delay their consumption or investment.

A culture of persistent payment delays can cause the government to lose financial credibility, leading contractors to respond by inflating contract prices to offset the opportunity cost of delayed payments or by denying services to the government in future. If arrears are omitted from fiscal aggregates, then the measured government deficit or indebtedness may be understated, together with the macroeconomic impact of the government's fiscal operations. These and other negative impacts have motivated efforts by governments, either on their own or with IMF program support, to reduce or eliminate arrears.

In Ghana, expenditure arrears have been a feature of government fiscal operations for a long time, yet the issue has received very little attention from economic researchers—if at all. This may be partly because the scale of the problem was not significant in the past. In recent years, however, arrears have risen to greater prominence due to increasing accumulation and payments. Although paying down arrears is recommended in the face of a sizeable build-up—as, for instance, it supports economic growth and a liquidity-constrained private sector—the recurrence of huge arrears undermines sound and effective fiscal management, and points to underlying systemic causes that require durable solutions.

This paper examines the nature, trend, causes and management of government expenditure arrears in Ghana. Its primary aim is to enable an appreciation of the problem and establish why it has grown and persisted, to lay the foundation for future research that will be devoted to analyzing its various impacts.

Section 2, which follows this introductory section, defines and explains the general concept of arrears, identifies the common types, and describes how arrears are treated in the fiscal accounts. Section 3 looks at how arrears are defined (identified) in Ghana's public accounts system, how they are treated in the fiscal tables, and the issues involved therein. The section also explains the nature and types of the arrears. Section 4 presents the trend in arrears accumulation and liquidation, and discusses the causes and management of arrears over the years. This is followed by some observations in Section 5, while Section 6 offers policy recommendations and concludes the paper.

## 2.0 General Definition & Treatment of Arrears

### 2.1 Definition

Three definitions of arrears stand out in the available literature on the subject. The first is found in the seminal work by Diamond and Schiller (1993), which defines government expenditure arrears as “the total outstanding obligations due for payment that the government has failed to discharge.” The IMF Government Finance Statistics Manual (GFSM, 2001) also states that “arrears arise when an obligatory payment is not made by its due-for-payment date.” In a more recent paper, Flynn and Pessoa (2014) define government expenditure arrears as “financial obligations that have been incurred by any level of the public sector for which payments have not been made by the due date.<sup>1</sup>”

Combining the common attributes in the above definitions, government expenditure arrears can be restated as the accepted financial obligations of government which have not been discharged after they became due for payment.

Three key characteristics of arrears can be discerned from this definition. The first is that the particular financial liability has been accepted by the government. This means there is no dispute over the claim, or the claim has been taken through the normal verification procedure and been validated as a true obligation of the government. The second characteristic is that the accepted obligation has become due for payment, while the third attribute is that the payment has not been discharged despite the due date passing. The due date or deadline for payment of an obligation may be determined by the applicable government financial law, regulation or custom; the underlying contract payment terms; or the type of expenditure involved. For any delayed payment, the value of the resulting expenditure arrears constitutes the amount of the original outstanding liability and any consequential interest or financial penalties which the government might incur.

A major import of the aforementioned characteristics of arrears is that not every unpaid bill of the government equates to arrears. This is because the payment due date may not have passed, a key requirement for arrears to occur, or the claim may be disputed. A rise in unpaid bills could however hint at potential arrears. Obligations arising from retroactive wage revisions are also not part of arrears, because they do not fall strictly into the category of delayed payments (Diamond and Schiller, 1993).

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<sup>1</sup> This definition views government in its broadest representation—the public sector. However, for fiscal reporting purposes, the meaning and coverage of government differs across countries, with some employing a narrower notion of government—that is, the central government or general government.

In addition to arrears arising from bills submitted by contractors and suppliers, other types of government expenditure arrears commonly identified include overdue wages, pensions and other deferred transfers to households; delayed mandatory transfers to sub-national governments, statutory (earmarked) funds and parastatal units; overdue tax refunds; and overdue debt service or amortization payments.

## 2.2 Treatment

The treatment of arrears in the fiscal accounts depends to a large extent on whether government transactions are recorded on a cash or accrual basis in the country of interest. In accrual accounting, transactions are generally recorded as soon as they occur, irrespective of whether cash is received or paid. This system automatically incorporates payment arrears in reported expenditure, since each transaction is recorded as soon as the benefit from it is received by the government. The expenditure and fiscal balance figures in this system measure the true impact of government operations on the economy, because they include all transactions by government, whether paid for or not. If fiscal tables are presented on an accrual basis, an “Other Accounts Payable” line item is included in the financing section to indicate the value of outstanding payments accrued in the financial year (See GFSM, 2001). This contributes to the total financing of the accrual fiscal balance. Not all accounts payable are arrears, however, as, for instance, a bill may be outstanding but not due for payment. Generally, to show the subset of accounts payable that is in arrears, additional information would have to be provided. This could then be shown as a memorandum item under the fiscal tables.

Although the IMF encourages governments to report on an accrual basis, the use of this system is prevalent mainly in Europe and the Americas, whereas in Africa and Asia cash-basis accounting dominates (EY, 2011). Under the cash basis, transactions are recorded only when cash is received or paid. Expenditure measured under this system excludes transactions by government which have not been paid for and the resulting unpaid bills or arrears. If arrears exist, cash-based fiscal aggregates give an incomplete picture of government fiscal operations and the macroeconomic effects of government fiscal policy. Only a special compilation can be used to determine the amount of accumulated arrears, the result of which may be shown as a memorandum item under the fiscal tables.

*In their Guidelines for Public Expenditure Management*, Potter and Diamond (1999) suggest two alternative presentations of arrears in the fiscal tables to deal with the shortcomings of cash-basis reporting. The first approach, termed a modified cash basis, measures expenditures on a commitment basis, with the difference between the resulting deficit and total cash financing indicated as “forced financing” by unpaid suppliers. The alternative approach first shows the deficit on a commitment basis. This is then added to the net change in arrears (new arrears less old arrears cleared) to give the overall cash deficit. In practice, many countries have found it difficult to implement any of these approaches. This is because expenditure reported on a commitment basis could overstate the level of arrears due to the fact that some commitments may not mature into obligations.<sup>2</sup> The other difficulty is that information on the prior stock of arrears, new arrears accumulated, and the portion that has been liquidated is required to implement the second approach but is not always readily available in many countries, usually due to poor monitoring of arrears by the Ministry of Finance or spending units.

<sup>2</sup> For instance, a contract that has been awarded and recorded as a commitment by the government may not be executed, and no financial obligation would therefore arise.



Expenditure to liquidate arrears is also reported differently in fiscal tables prepared under the accrual as opposed to the cash basis. Under accrual accounting, arrears (and all other payables) are recognized as balance sheet debt or liabilities as soon as they occur, and subsequent payment is recorded by debiting the value of “Other Accounts Payable” on the government’s balance sheet. This means that arrears clearance in the accrual system is a balance sheet transaction that does not impact expenditure or the fiscal balance (in accrual terms) in the current financial year. On the other hand, under the GFSM, 2001 cash basis of reporting, the payment of arrears is recorded as part of government expenditure in the current financial year under “Other Payments.” Thus expenditure measured in cash terms includes cash releases for current-year financial obligations as well as cash payments to liquidate arrears. The netting of total cash expenditure from total cash revenue yields the cash fiscal balance.

### 3.0 Definition, Treatment and Types of Arrears in Ghana

Although the general concept of government expenditure arrears has been established in the literature, the precise definition of arrears differs across countries. This is mainly because of differences in payment practices between countries, in particular differences in what may be considered legally permissible or acceptable payment delays. The treatment of arrears in fiscal accounts and tables also varies and depends on accounting conventions (cash or accrual) adopted by countries. Additionally, arrears of a particular kind may be prevalent in one country but be less of a problem in another. These differences call for an understanding of what constitutes government expenditure arrears in Ghana, the nature and types of the arrears, and the manner in which they are treated in the fiscal accounts to help delineate the issue and prepare the ground for the rest of the discussions in the paper.

#### 3.1 Definition and Treatment

A standard definition of government expenditure arrears does not exist in the legal and regulatory framework for public finance in Ghana.<sup>3</sup> In the absence of an unequivocal definition, practice and ad hoc criteria have most often held sway in determining what constitutes expenditure arrears of government. Certain types of obligations, for instance wages and earmarked transfers to statutory funds, may not call for an explicit definition to establish when they have converted into arrears. Wage arrears automatically occur if workers’ salaries, normally due at the end of the month, are not paid. For statutory funds, the legislations that set them up often stipulate when transfers should be made; any delay would thus lead to arrears normally due at the end of the month, are not paid. For statutory funds, the legislations that set them up often stipulate when transfers should be made; any delay would thus lead to arrears. But for payments which require the submission of a bill or invoice by the creditor—mainly goods and services, and assets expenditure—an unambiguous standard for classifying these as arrears is needed. This helps to identify those invoices for which payment has been unduly delayed, often due to the unavailability of funds.

<sup>3</sup> Neither the Financial Administration Act (Act 654, 2003), the Financial Administration Regulations (2004), nor any other public finance code or manual specifies a definition of expenditure arrears (Act 654 was repealed in August 2016 and replaced with the Public Financial Management Act (Act 921, 2016), but this also lacks a clear definition of expenditure arrears).

In practice, the Ministry of Finance allows up to 90 days from the receipt of an invoice before it begins to accumulate interest or penalties if not paid. This 90-day window has been interpreted as the maximum delay period before an outstanding liability falls into arrears.<sup>4</sup> This criterion was used by the IMF to track the stock of payment arrears in the road sector during Ghana's two successive Poverty Reduction and Growth Facility (PRGF) programs in 2001-2006. An arrear was defined within the context of the PRGF programs (See IMF, 2002) as "a duly certified expenditure commitment that was not paid during a period of 90 days after the date the bill was issued."

This definition has not been consistently applied, however, even in IMF programs. For instance, in the government's 2009-2012 IMF Extended Credit Facility (ECF) program, a new definition was used to monitor arrears to contractors. These were defined as "payments due and not settled within 30 days after the end of the fiscal year." Total arrears were defined as the sum of arrears to contractors, arrears to statutory funds, and wage and pension arrears. Arrears to statutory funds were described as "any delay of more than one month in revenue transfers to the funds relative to the normal payment schedule," while wages and pensions arrears were "payments outstanding after the agreed date for payment to staff or the social security fund." For the purposes of the ongoing 2015-2017 ECF program of the government, arrears to contractors have been redefined as "approved invoices on the GIFMIS<sup>5</sup> system that remain unpaid three months after the quarter in which the invoices were approved by the MDA" (IMF, 2015).

The changing definitions indicate that arrears have not been measured in a consistent way over time. The bigger issue, however, is the absence of a clear definition outside the ad hoc ones employed in Fund programs. The Ministry of Finance's 90-day rule for arrears on invoices, which seems like a good-enough way to measure this subset of arrears, has been found not to be uniformly applied by all Ministries, Departments and Agencies (MDAs) to determine their arrears. Doubts have therefore been expressed about the accuracy of data reported on the stock, flow and clearance of arrears.<sup>6</sup> These doubts appear to have some validity, because for the 2012 financial year, for instance, conflicting data have been published by the Ministry of Finance on arrears payments. Within the fiscal tables for the year, the amount of arrears liquidated was reported as GH¢3.7 billion, but other data published by the same Ministry indicate arrears clearance of GH¢420.8 million in 2012.<sup>7</sup>

Potentially understated or overstated arrears obfuscate the nature of the problem and yield data which undermine inter-temporal comparisons. Nevertheless, this paper is constrained to use the available official data on arrears but also points out discrepancies in the data wherever they arise.

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<sup>4</sup> For instance, Flynn and Pessoa (2014) list Ghana among countries where the period before an outstanding payment becomes arrears is 90 days.

<sup>5</sup> GIFMIS stands for the Ghana Integrated Financial Management Information System, which is the new software system for managing the public finances in Ghana.

<sup>6</sup> See Ghana: *Public Expenditure and Financial Accountability Performance Review, Final Report, June 2013*.

<sup>7</sup> Section 3 highlights more of these discrepancies and the sources of the conflicting data.

In presenting arrears in government fiscal tables in Ghana, it is the payment of arrears, not the incurrence of it, which is reported. This is because the accounts are presented on a cash basis, which has no place for unpaid bills except when they are stated as a memorandum item under the fiscal tables. This is hardly done, however. Even in a more comprehensive document such as the budget statement, information on the stock of arrears or newly-accumulated arrears is generally not found. The only exceptions were in 2009, 2010 and 2011, when, in addition to payments information, arrears stock figures were provided in the original and supplementary budget statements of the period.

In the fiscal tables (See Table 1 showing examples from 2014 and 2015), arrears payments, made up of road and non-road arrears clearance, are presented as a balancing item, which is added to tax refunds to derive the “Overall Cash Balance” from the “Overall Commitment Balance.” The overall cash balance is then adjusted by net divestiture receipts and a discrepancy item to produce the final balance, known as “Overall Balance Including Divestiture and Discrepancy.”

**Table 1: Summary of 2014-15 Fiscal Tables (Amounts in GH¢m)**

Item	2014	2015
A. Total Revenue and Grants	24,745.5	31,088.3
B. Total Expenditure	31,962.2	37,344.6
Compensation of Employees	10,466.8	12,111.2
Use of Goods and Services	1,776.6	1,388.2
Interest Payments	7,080.9	9,075.3
Subsidies	473.7	25.0
Grants to Other Government Units	4,850.8	6,801.3
Social Benefits	0	0
Other Expenditure*	1,217.7	2,058.7
Capital Expenditure	6,095.7	5,884.9
<b>C. Overall Balance (Commitment)</b>	<b>-7,216.7</b>	<b>-6,256.3</b>
D1. Road Arrears	-231.7	-549.6
D2. Non-Road Arrears	-2,934.5	-2,149.1
D3. Tax Refunds	-156.7	-627.0
<b>E. Overall Balance (Cash)</b>	<b>-10,539.6</b>	<b>-9,582.0</b>
F1. Net Divestiture Receipts	0	0
F2. Discrepancy	-96.6	143.8
<b>G. Overall Balance (Including Divestiture and Discrepancy)</b>	<b>-10,636.3</b>	<b>-9,438.2</b>

Source: Ministry of Finance (2015; 2016) \*Represents tax expenditure

There are a couple of issues with this presentation. First, the treatment of arrears payments as a balancing adjustor is inconsistent with the format recommended in the GFSM, 2001 and the IMF’s Special Data Dissemination Standard (SDDS, 2007). In the GFSM and SDDS, for countries such as Ghana that report on a cash basis, reported total expenditure should include all cash expenditure, both for current payments and arrears clearance. The latter is shown as part of “Other Expense” or “Other Payments” under total expenditure.

The second anomaly in Table 1 concerns Item C, the overall commitment balance. This seems to imply that the reported expenditure is based on commitments. Commitments, according to the GFSM, 2001, represent expenditure measured at the point when the government commits itself to a transaction. By this definition, commitment expenditure includes cash expenditure, payables (which include arrears), and purchase orders not yet fulfilled. It seems, however, that this is not what Item C actually stands for in Table 1, since if that was the case, the separate recording of arrears clearance would amount to double counting of expenditure. What is apparent is that Item C is a misnomer and should be relabelled as a cash balance.

Table 2 shows an alternative presentation of the items in Table 1. Here, the elements have been rearranged to conform to the GFSM, 2001 and SDDS, 2007 presentation. The payment of arrears is recorded as part of "Other Payments" and contributes to the total expenditure used to derive the cash balance. The overall balance is the cash balance adjusted by a discrepancy item. Two balances without arrears clearance have been shown as memorandum items, since these may be required for certain analytical purposes.

**Table 2: Summary of 2014-15 Fiscal Tables Based on GFSM, 2001 and SDDS, 2007**

Item	2014	2015
A. Total Revenue & Grants	24,745.5	31,088.3
B. Total Expenditure	35,285.1	40,670.3
Compensation of Employees	10,466.8	12,111.2
Purchases of Goods and Services	1,776.6	1,388.2
Interest Payments	7,080.9	9,075.3
Subsidies	473.7	25.0
Grants to Other Government Units	4,850.8	6,801.3
Social Benefits	0	0
<b>Other Payments</b>	4,540.6	5,384.4
<b>Arrears Clearance</b>	3,166.2	2,698.7
Tax Expenditure	1,217.7	2,058.7
Tax Refunds	156.7	627.0
Net Cash Outflow from Investments in Nonfinancial Assets*	6,095.7	5,884.9
C. Cash Balance (A-B)	-10,539.6	-9,582.0
D. Discrepancy	-96.6	143.8
E. Overall Balance (C+D)	-10,636.3	-9,438.2
<u>Memorandum Items</u>		
Cash Balance (Without Arrears Clearance)	-7,373.4	-6,883.3
Overall Balance (Without Arrears Clearance)	-7,470.1	-6,739.5

Source: Author's rearrangement of Table 1 data \*Equivalent to Capital Expenditure in Table 1

### 3.2 Nature and Types

Government expenditure arrears are not a recent phenomenon in Ghana. In fact, payment arrears have a long history within the government sector. Their nature has however evolved over the decades, influenced by the types of broader macroeconomic and fiscal problems the government has faced at various times. For instance, in the 1970s-80s, government arrears were mostly deferred foreign debt service payments and deferred foreign trade liabilities. These had been accumulated as a financing strategy for the large balance of payments deficits recorded in those years.<sup>8</sup> The size of the external payment arrears was US\$161 million in 1975. This increased to US\$577 million in 1982 but decreased to US\$440 million in 1983 (Loxley, 1991).

The arrears curtailed Ghana's access to external finance and played a role in aggravating the country's economic plight. One of the goals of the Economic Recovery Program (ERP) which kicked off in 1983 was to gradually pay down the arrears to restore the country's damaged financial credibility abroad. This was to be achieved by reforms to correct the distortions in the foreign exchange market, progressive trade and capital account liberalisation, and increased inflow of aid that would set the country on a path to overcoming its foreign exchange liquidity constraints. From a stock of US\$440 million in 1983, the external arrears were paid down to US\$17 million in 1989. In 1990, the government extinguished the remaining amount.

All this time domestic expenditure arrears had not emerged as a major fiscal problem. In the 1990s, however, just as the country was closing the chapter on its external payments difficulties, domestic expenditure arrears came to the fore as a recurring fiscal challenge, reflecting weak control of public expenditure. These arrears have since become the dominant form of government arrears, with foreign arrears largely extinct since 1990.

Domestic expenditure arrears are classified into two broad categories: "Road Arrears" and "Non-Road Arrears." Road arrears are outstanding payments due to contractors who have executed road projects for the government. Initially, these were the only arrears explicitly identified by the government. Non-road arrears, which surfaced in 1999, encompass all other arrears, including overdue obligations to contractors outside the road sector; outstanding payments to suppliers of goods and services to government, including unpaid utility bills; outstanding wages and salaries payments; overdue transfers to statutory funds, including the District Assemblies Common Fund (DACF), Ghana Education Trust Fund (GETFund), National Health Insurance Fund (NHIF), and Social Security Fund; and transfers owed to Stated-Owned Enterprises (SOEs), which include unpaid subventions and subsidies.

Traditionally, the coverage of government expenditure arrears in Ghana has been limited to central government arrears, made up of expenditure arrears of MDAs and direct central government arrears to public, quasi-public and private institutions. The arrears of statutory funds, sub-national governments and state-owned enterprises are often excluded, but included are central government arrears to these public sector arms. These mostly consist of overdue obligatory transfers.

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<sup>8</sup> This was a period marked by extremely adverse terms of trade for Ghana, which, in the presence of a fixed official exchange rate and capital controls, led to an acute shortage of foreign exchange to meet international liabilities.

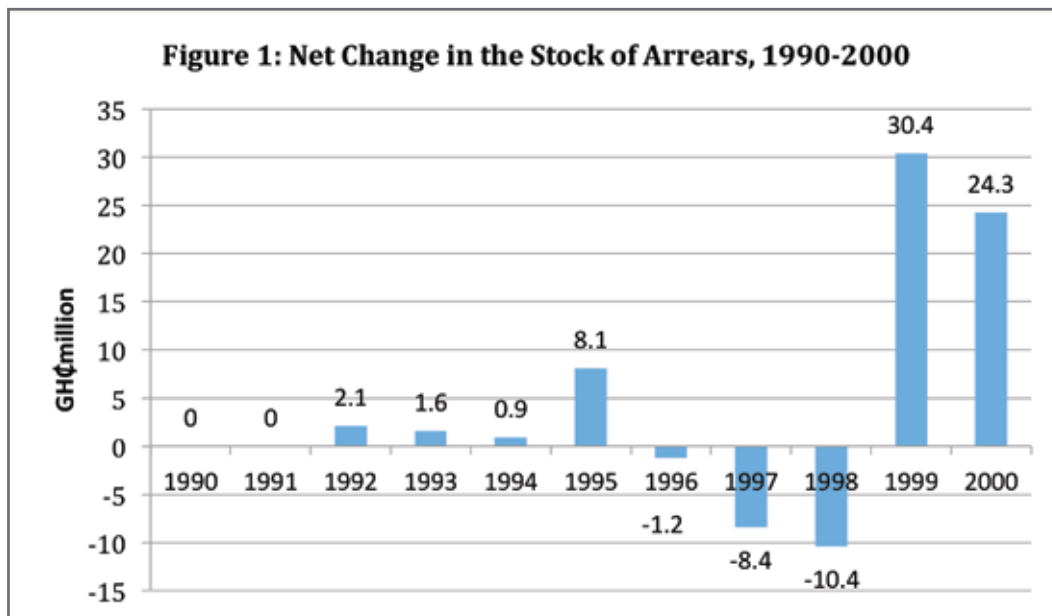
In 2010, following a major decision to retire all arrears that posed a significant risk to the economy, the government broadened the coverage of its arrears to include certain overdue financial liabilities of SOEs in the energy sector. Some liabilities of Cocobod, the public sector regulator of the cocoa industry, were also covered in 2012. Save for these instances, the traditional coverage of government arrears has generally applied.

## 4.0 Trends in Arrears, Causes and Management

As previously stated, domestic expenditure arrears became a fiscal management issue of concern from the early 1990s. On the one hand, the emergence of the arrears appeared to have resulted from an unsustainable fiscal policy stance in the run-up to and after the country's democratization in 1992. On the other hand, it exposed systemic financial management lapses in the government sector. Failure to correct these lapses through comprehensive financial management reforms has made arrears a routine outcome of budget execution for the past 20 odd years.

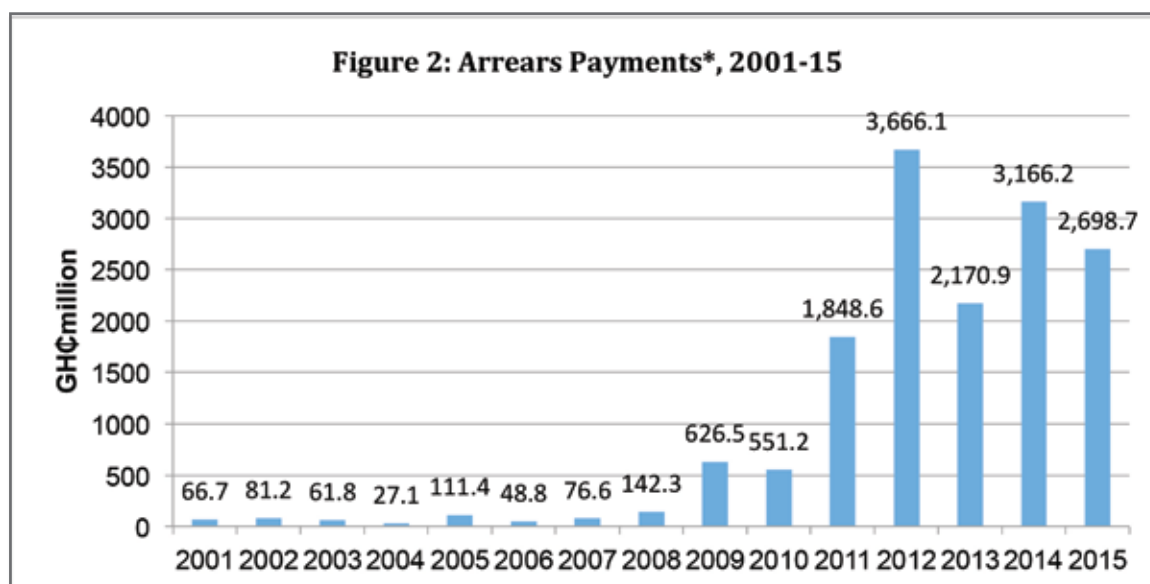
### 4.1 Trends in Arrears Accumulation and Expenditure

Assessing the growth of domestic arrears year-to-year is hindered by a failure of the public accounts system to systematically and consistently track and report on the stock of arrears at the end of each financial year. This problem is overcome in this paper by relying on other available information that gives a sense of the magnitude and rate of accumulation of arrears. This information includes data on the net change in the stock of arrears reported for 1990-1998 and extrapolated for 1999-2000 (Figure 1), and arrears payments information for each financial year from 2001-2015 (Figure 2). Stock data available for some years complement the analysis. Arrears payments as a ratio of total government expenditure and of GDP from 2001-2015 is also used to give a sense of how the fiscal and economic burden of arrears has evolved (Figure 3).



Source: IMF, Ministry of Finance, Author's calculations

The information in Figure 1 on the net change in the stock of arrears shows a continuous build-up from 1992 to 1995. Prior to this, there were zero additions to arrears in 1990 and 1991. In 1992, there was a net increase in arrears of GH¢2.1 million (0.7 percent of GDP), followed by net increases of GH¢1.6 million (0.4 percent of GDP) in 1993, GH¢0.9 million (0.2 percent of GDP) in 1994 and GH¢8.1 million (1.0 percent of GDP) in 1995. Cumulatively, the net increase in arrears was GH¢12.7 million from 1992-1995, equivalent to an annual growth rate of 0.6 percent of GDP. From 1996-1998, there were net reductions in arrears, by GH¢1.2 million in 1996, GH¢8.4 million in 1997 and GH¢10.4 million in 1998. In 1999-2000, however, the situation worsened markedly following a terms-of-trade shock and fiscal deterioration, with an estimated net increase in arrears of GH¢30.4 million (1.5 percent of GDP) in 1999 and GH¢24.3 million (0.9 percent of GDP) in 2000. A subsequent audit established the stock of domestic arrears at the end of 2000 to be GH¢67.7 million, equal to 2.5 percent of GDP.

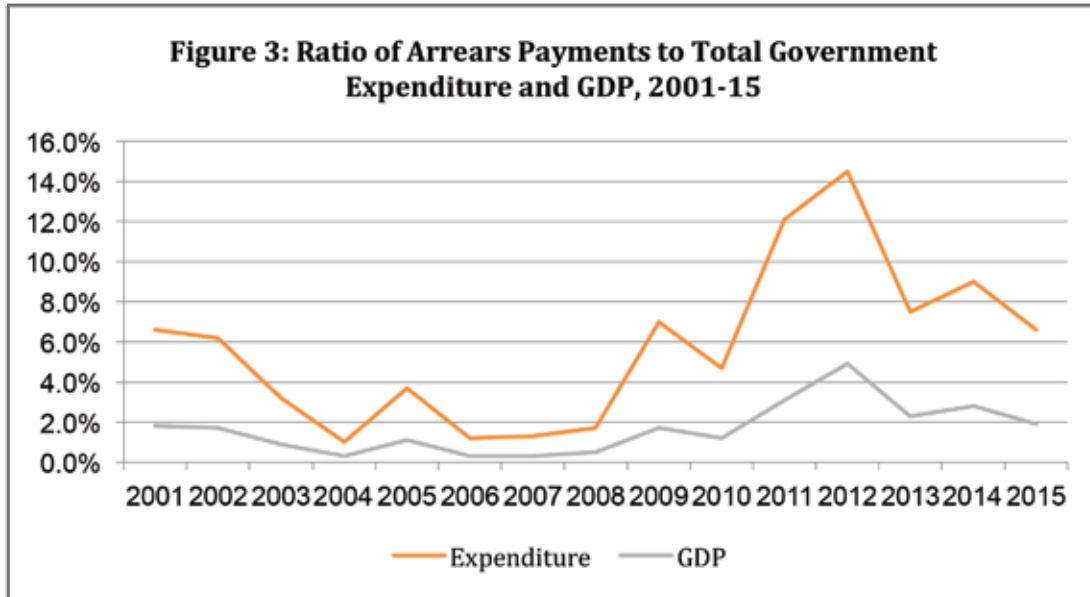


Source: Ministry of Finance \*include payment of wage arrears, SOE arrears and SOE liabilities from 2011

Figure 2, which shows arrears expenditure from 2001-2015, helps to illustrate the significance of the arrears problem after 2000, in the absence of stock or changes in stock figures. Arrears clearance was GH¢66.7 million (1.8 percent of GDP) in 2001, increased to GH¢81.2 million (1.7 percent of GDP) in 2002, fell to GH¢61.8 million (0.9 percent of GDP) in 2003 and to GH¢27.1 million (0.3 percent of GDP) in 2004. In 2005, it rose sharply to GH¢111.4 million, then decreased to GH¢48.8 million in 2006. From 2007, it assumed an upward trend, with a particularly steep jump in 2009 to GH¢626.5 million. This large payment followed an evaluation exercise which found GH¢1.8 billion (6.0 percent of GDP) of arrears outstanding at the end of 2008.

To reduce the impact of these arrears on the economy, the government adopted an arrears management strategy in 2009. More arrears were cleared in 2010 (GH¢551.2 million) and 2011 (GH¢1.8 billion). This comprised settlement of both pre-2009 arrears and new arrears accumulated between 2009 and 2010. For 2012, the reported expenditure on arrears in the government's fiscal accounts was twice the clearance in 2011, at GH¢3.7 billion (4.9 percent of GDP), which was blamed largely on higher payment of wage arrears arising from the implementation of the new Single Spine Pay Policy.

Although arrears expenditure fell after 2012, it remained at a high level, with GH¢2.2 billion and GH¢3.2 billion paid in 2013 and 2014 respectively. According to the government and the IMF, there was still an outstanding stock of arrears of GH¢6.2 billion at the end of 2014 (IMF, April 2015). In 2015, reported arrears clearance was GH¢2.7 billion (Figure 2).

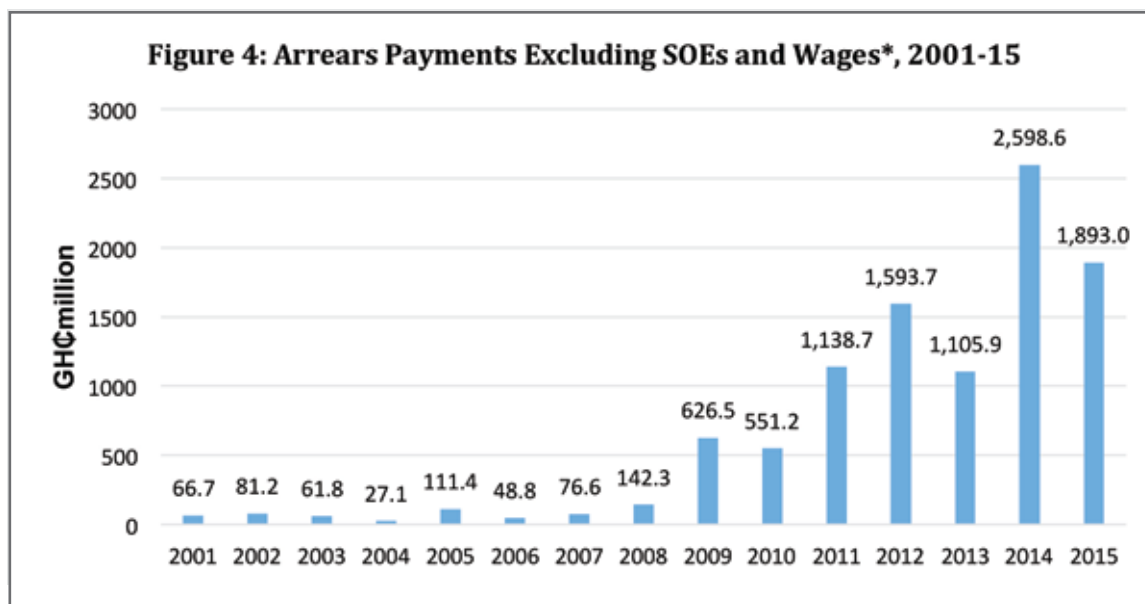


Source: Ministry of Finance data

Figure 3 shows that arrears payment was initially large relative to total government expenditure (6.6 percent) and GDP (1.8 percent) in 2001. Subsequently, it declined to lower ratios over 2002-2008, despite an out-of-trend increase in 2005. From 2009, arrears payments assumed a mounting proportion of total government spending, reaching a peak of 14.5 percent of expenditure in 2012. In relation to the size of the economy, arrears clearance, which was under 2.0 percent of GDP between 2001 and 2007, climbed rapidly after 2008, eventually reaching the highest recorded level of 4.9 percent of GDP in 2012. Although both the ratios to expenditure and GDP fell in 2013-2015, the levels were still much higher than the pre-2008 period.

Before going ahead to discuss the underlying causes of these arrears, it is necessary to qualify some of the data presented in Figure 2. This qualification concerns certain special factors that partly explain the surge in arrears payments after 2008. The first is that the processes for recording and monitoring arrears were strengthened from 2009, which brought to the fore large arrears that had been accumulated up to the end of 2008. The considerable arrears clearance in 2009-2010, which was a sharp departure from previous levels, therefore reflected the significant stock outstanding in 2008. Second, there was a change in the coverage of arrears in 2010 to include SOE liabilities and also a change in wage policy, which caused the government to accrue substantial wage arrears. This partly accounted for the further steep rise in arrears expenditure from 2011 onward.





Source: Ministry of Finance data \*2009-2012 figures exclude SOE-related arrears and wage arrears, but 2013-2015 exclude wage arrears only due to unavailability of SOE data for the period.

In Figure 5, the data in Figure 2 is corrected for these factors by excluding arrears payments related to SOEs and the new wage policy from the post-2008 figures.<sup>9</sup> The resulting figures are evidently lower than those in Figure 2, showing the reasonably strong contribution of the change in arrears coverage and the new wage policy to overall arrears expenditure in the post-2008 period. Nevertheless, Figure 5 still reveals a steep rise in arrears expenditure after 2008, which is indicative of increased arrears accumulation in the period.

## 4.2 Causes of the Expenditure Arrears

The causes of expenditure arrears in Ghana can be summarized into four fundamental weaknesses in the public financial management system. These are weak budget planning and preparation; poor budget execution; budgetary indiscipline; and political interference with agreed fiscal and financial management policies.

### 4.2.1 Weak Budget Planning & Preparation<sup>10</sup>

Budget planning and preparation is very weak in many respects. The common problems include the following:

- *Lack of realism of the budget:* Budget statements in Ghana are prone to overestimate revenue and underestimate expenditure.<sup>11</sup> This comes about through weaknesses and uncertainties at the preparation stage of the budget process. First, a weak underlying macroeconomic framework and less-than-robust economic assumptions tend to undermine the credibility of fiscal estimates. Second, the budget's reliance on external grants and natural resource revenues exposes it to the vagaries of these revenue sources.

<sup>9</sup> For 2013-2015, only wage arrears have been excluded since information on the SOE component of arrears payments was not available.

<sup>10</sup> The discussion of the budget's weaknesses in this section benefitted from work done by Kusi (2012).

<sup>11</sup> Kwakye and Owoo (2014) found in a review of budget outcomes over the 10-year period from 2004-2013 that actual revenue undershot estimated revenue half of the time, while budgeted expenditure was exceeded in all but three years.

The result is that the actual flow of resources is time and again insufficient to satisfy planned expenditures. Given this fundamental mismatch, even if spending units limit the commitments they incur to their budget appropriations, they are not likely to receive adequate funds to pay for them, causing arrears to be accumulated. On the expenditure side, some common occurrences accentuate the unrealistic nature of the budget. These are underfunding of MDAs' budget requests, inadequate provision for prior-year commitments and contingent liabilities, and under-provisioning for wages and salaries expenditure. The main reason for the latter is that public sector wage negotiations invariably take place after the budget has been prepared, and very often the agreed wage increase exceeds the assumption made in the budget. These budgeting practices increase the likelihood of expenditure overruns and the build-up of unfunded commitments that eventually become arrears.

- *Poor medium-term planning:* Although since 1999 the budget has been presented within a medium-term framework spanning three years, the projections, especially for the outer years, are often unreliable. It appears, given the recurrence of wide deviations from planned estimates, that no realistic costing of policies, projects and programs with financial implications beyond the current budget year is undertaken. Such a failure exposes the government to potential future liabilities that have not been factored into medium-term projections.
- *Limited flexibility of the budget:* The budget's flexibility—the ability of the government to exert control over expenditure allocations and review spending decisions to deal with emerging fiscal challenges and risks—is severely limited by the excessive use of revenue earmarking to pre-determine expenditure. This aggravates the situation where wages and interest expenditure are already treated as quasi-statutory expenditures that cannot be easily cut or deferred without the government risking serious socio-political and legal repercussions. Arrears, including to the earmarked funds themselves, have therefore been used frequently to mitigate the budget's inflexibility.

#### 4.2.2 Poor Budget Execution

- *Weak commitment control and monitoring:* The second stage of the expenditure process following authorisation by parliament is the level of incurring commitments. This is the point where a contract is awarded or an order is placed for supplies to be delivered. A commitment is also incurred when there is new employment into the public sector. Ideally, the commitments entered into by a spending unit or MDA should be tied to the expenditure ceiling of that MDA or its available cash resources. Furthermore, the commitment should only be in respect of expenditure catered for in the budget. The reality, however, is that the control of commitments is weak and made worse by the unpredictability of budget releases. As such, many MDAs tend to incur obligations far in excess of their expenditure ceilings or cash balances, or even their budget appropriations. The inability to discharge these commitments when they mature causes arrears to be created.
- *Information gaps and reporting lags:* Information on commitments, verified obligations, payment orders issued, as well as discharged payments is often not timeously generated or comprehensive. The use of “early warning reports” on the expenditure side, detailing commitments versus cash payments and indicating potential arrears, is also sparse.

This has led sometimes to arrears being created on the blind side of the Ministry of Finance. Oftentimes, without a comprehensive compilation or audit, it is difficult to put a finger on the actual size of arrears.

- *Poor cash management:* Arrears have sometimes been accumulated because of poor cash management. Effective cash management requires, among others, reliable cash forecasting and the timely reconciliation of bank statements with budget accounts to determine cash expenditures made and the availability of unencumbered balances. Weak cash forecasting or a fuzzy grasp of the cash position of the government makes it difficult to contain commitments within the constraints of actual available funds.
- *Payment processing delays:* Delays in the processing of expenditure transactions are quite common among MDAs in Ghana. These are caused both by liquidity challenges and administrative inefficiencies. Sometimes, however, the delay is deliberately contrived by officials to force a frustrated creditor to pay an inducement to expedite the payment. Long delays, sometimes exceeding a whole year, in processing new employees onto the payroll also create wage arrears, as when the new recruits are eventually admitted onto the payroll, their unpaid salaries instantaneously become expenditure arrears.

#### 4.2.3 Budgetary Indiscipline

- *Override of commitment controls:* Even when commitment controls have been instituted or strengthened, they have been overridden on many occasions, especially when demanded or sanctioned by an official with political authority. Override of controls has been the norm typically in election years, when spending pressures are ramped up, leading to expenditure overruns and arrears. In both 2008 and 2012, commitment controls broke down, causing the racking up of substantial arrears in addition to cash expenditure overruns.
- *Lack of sanctions:* Many of the arrears incurred in the past were caused by flagrant infractions of the financial laws and regulations of the public sector. Some of the contracts that eventually produced liabilities for the government were awarded without proper authorisation or without being subjected to a competitive tendering process, as is mandated by the Public Procurement Act (Government of Ghana Budget, 2010). But hardly were any sanctions applied to the responsible officials. Such impunity has prevailed partly because the public finance legislations have for long lacked strong and effective sanctions for offences. On the contrary, sanctions such as dismissal or jail terms for public officials that engage in unauthorized spending are not uncommon in other countries.

#### 4.2.4 Political Interference

- Politicians have historically displayed a lack of commitment to agreed fiscal and financial management policies by circumventing budgetary curbs and expenditure controls to advance their political interests. It is no coincidence that the budget deficit and arrears tend to increase sharply together during election years. When faced with financial constraints vis-à-vis pressure to spend resources to curry favour with voters ahead of elections, incumbent politicians invariably use arrears as a financing strategy to boost the spending of government to further their political ends.

A common manifestation of political interference is the recurrence of unbudgeted subsidy liabilities to SOEs. In 2000, 2008 and 2012, unbudgeted and unfunded energy subsidies occurred because of the failure of the government to allow the prices of fuel and utilities to rise in line with market conditions. This resulted in huge government arrears to SOEs in the energy sector, which in turn accumulated liabilities to banks and trade creditors. In most cases, the financial system was almost brought to its knees by the SOE liabilities, which locked up banks' capital, increased the level of non-performing loans among banks, and caused a credit crunch in the economy.

A sad consequence of interference is that past reforms are rolled back, such as happened in 2008. Prior to the fiscal downside which began two years earlier and continued up to that year, the government had achieved notable strides in instituting commitment controls to prevent arrears. A Commitment Control System Operating Manual had been produced in 2003, and the magnitude of arrears was reduced substantially. But the controls caved in to political spending pressure in 2008, setting the country back again after years of painful fiscal reforms.

### **4.3 The Management of Arrears**

The discussion of arrears management is divided into four distinct periods: 1990-2000, when domestic arrears started to build up and substantially increased at the end of the decade; 2001-2008, when the problem was initially brought under control under a new administration but escalated as fiscal management weakened; 2009-2012, which was marked by the liquidation of huge legacy arrears and the emergence of considerable wage arrears after a new public sector pay policy was implemented; and 2013-15, which has seen continued large accumulation and clearance of arrears amid conditions of significant fiscal and economic deterioration.

#### **4.3.1 Management During 1990-2000**

Towards the end of the 1980s, the government started to make a big push in the area of economic infrastructure development to shore up the country's growth prospects in a period of structural adjustment. This push continued in the 1990s and was reflected in an eight-fold jump in budgetary capital expenditure in the first half of the decade, outstripping the seven-fold increase in total government expenditure. As a share of GDP, capital expenditure soared from 6.3 percent in 1990 to 14.0 percent in 1995. Road construction, rehabilitation and maintenance was the biggest beneficiary of this spending, in line with the government's vision of radically transforming the generally bad road network to enhance the mobility of people and goods, reduce transport costs and boost productivity. In the event, lots of contracts for road development were awarded, sometimes indiscriminately and without regard for the limits set by the budget. When the payments came due, some had to be deferred, resulting in arrears. In certain instances, too, costs escalated, either through unauthorised variation or extension of the contract or due to inflation and currency depreciation. This meant the full obligations to the contractors could not be met from the budgeted funds, causing arrears to be accumulated. Since many road projects were backed by foreign grants and loans, the periodic shortfalls in disbursements of these funds by donors and lending institutions also tended to aggravate the arrears build-up.

The government's budget statements from 1991-1995 recognized the existence of these road arrears, with indications that they would be settled through future budgetary appropriations.

However, the amounts involved were not stated, nor were the expected payments to be made. Changes in the stock of these arrears were however quantified by the IMF in reports on its economic program with Ghana during the 1990s. These showed a consistent annual net increase in arrears from 1992, reaching its peak in 1995 (IMF, 1998). According to the IMF data (See Table 3), the change in arrears was zero in 1990 and 1991 but rose to GH¢2.1 million in 1992, representing 3.1 percent of total government expenditure and 0.7 percent of GDP. In 1993, there was a net increase of GH¢1.6 million in arrears, representing 1.4 percent of expenditure and 0.4 percent of GDP. In 1994, the growth was GH¢0.9 million, representing 0.6 percent of expenditure and 0.2 percent of GDP. These net increases implied that new, larger arrears were being incurred (or discovered) even as some outstanding amounts were settled.

In the 1992 budget statement, the government partly blamed inadequate supervision of contracts for the arrears in the road sector. In the 1994 budget statement, it conceded that “the expenditure control system seems to have broken down, and a number of commitments have been entered into without due regard to the financial regulations.” It then promised to tackle the problem by introducing the Expenditure Tracking and Control System (EXTRACON) to record and monitor all commitments by MDAs with the view to checking excesses. In 1995, however, the build-up of road arrears worsened, as there was a net increase in the stock by GH¢8.1 million, equal to 1.0 percent of GDP and almost four times the level in 1992. The additional arrears, which amounted to more than a quarter of the 1995 cash budget deficit, came about because the budgetary allocation for road expenditure was overspent by more than 2.0 percent of GDP (IMF, 2000).

**Table 3: The Net Flow of Arrears, 1990-95**

Item	1990	1991	1992	1993	1994	1995
Net change in stock of arrears (GH¢m)	0	0	2.1	1.6	0.9	8.1
o/w Road arrears	0	0	2.1	1.6	0.9	8.1
Non-road arrears	0	0	0	0	0	0
Net change as % of Government Expenditure	0	0	3.1	1.4	0.6	3.6
Net change as % of GDP	0	0	0.7	0.4	0.2	1.0

Source: IMF, Ministry of Finance, Author's calculations

In 1996, the government recognized that the growth of road arrears was worrying and budgeted GH¢6.4 million (2.7 percent of total expenditure) to pay down the arrears. The actual expenditure was GH¢5.9 million, but due to the accumulation of new arrears, the stock of arrears declined by a lower-than-anticipated amount of GH¢1.2 million at the end of 1996 (See Table 4). Some road contracts were meanwhile renegotiated to bring them within budgetary limits (IMF, 1997). In 1997 and 1998, there were net reductions in the stock of arrears, by GH¢8.4 million and GH¢10.4 million respectively. Nevertheless, at the end of 1998, road arrears persisted due to continuing weak expenditure control, especially at the commitment stage. The stock outstanding at the end of that year was put at GH¢13.0 million, equal to 0.8 percent of GDP (IMF, 1999).

Under the government's 1999-2001 economic program with the IMF, it was agreed to eliminate all outstanding road arrears by end-2000 and take steps to prevent new arrears from being accumulated. An audit of road contracts was conducted in 1999, and it was decided to terminate some of them and scale back expenditure on others. Steps taken to prevent a build-up of new arrears included a revision of contract-awarding procedures to conform to World Bank

procurement guidelines and the adoption of a medium-term expenditure framework (MTEF) to enable multi-year budgeting for multi-year investment projects.

Despite these measures, and road arrears payments of GH¢13.0 million in 1999, the stock of road arrears rose to GH¢27.8 million (1.4 percent of GDP) at the end of the year. The increase occurred because of high interest incurred on the old arrears and a timid commitment-control effort, which failed to avert further unbudgeted road expenditures. The government also recorded outstanding non-road liabilities of GH¢15.6 million (0.7 percent of GDP) in 1999, giving an overall identified arrears stock of GH¢43.4 million, a 234 percent jump over 1998. The 1999 non-road arrears were a significant development because hitherto the expenditure arrears which had been reported in the budget statements and fiscal accounts comprised of only road sector outstanding payments. The emergence of non-road arrears thus evinced a problem that had gotten out of hand.<sup>12</sup>

**Table 4: The Net Flow of Arrears, 1996-2000**

Item	1996	1997	1998	1999	2000
Net change in stock of arrears (GH¢m)	-1.2	-8.4	-10.4	30.4	24.3
o/w Road arrears	-1.2	-8.4	-10.4	14.8	-12.8
Non-road arrears	0	0	0	15.6	37.1
Net change as % of Expenditure	0.3	2.0	2.1	5.7	3.0
Net change as % of GDP	0.1	0.6	0.6	1.5	0.9
<b>Memorandum Items</b>					
Identified stock of arrears at year-end (GH¢m)	-	-	13.0	43.4	67.7*
o/w Road arrears	-	-	13.0	27.8	15.0
Non-road arrears	-	-	0	15.6	52.7
Stock of arrears as % of GDP	-	-	0.8	2.1	2.5

Source: IMF, Ministry of Finance, Author's calculations \*This figure excludes external arrears of US\$89m (GH¢62.7m, equal to 2.3 percent of GDP) accumulated between 1999 and 2000.

From 1999-2000, the fiscal situation came under stress from deteriorating international terms of trade, caused by falling prices of gold and cocoa, the mainstay of government revenue, and a surge in the price of crude oil, the largest import commodity. The impact of the terms-of-trade shock was magnified by a shortfall in financial assistance from donors, while spending pressures intensified ahead of the December 2000 elections. These events caused the fiscal deficit to widen in 1999 and 2000, registering 8.6 percent of GDP in the latter year against a target of 5.6 percent. The current account deficit also recorded a high level of 8.7 percent of GDP at end-2000.

The expenditure management and control systems succumbed to the myriad pressures on the economy, and the government accumulated more arrears in 2000, passing on to the new administration an identified stock of GH¢67.7 million, equivalent to 2.5 percent of GDP. Seventy-eight percent of the arrears (GH¢52.7 million or 2.0 percent of GDP) were non-road arrears, while the remainder (GH¢15.0 million or 0.5 percent of GDP) were road arrears. The non-road arrears included deferred obligatory transfers to the District Assemblies Common Fund (DACF)

<sup>12</sup>This may not have been the first time non-road arrears were incurred, but it was the first time the government explicitly identified these arrears.

and the Ghana Education Trust Fund (GETFund).<sup>13</sup> In addition to the domestic arrears, the balance-of-payments crisis the country experienced forced the accumulation of foreign debt service arrears to the tune of US\$89 million (2.3 percent of GDP) by end-2000. In all, the total domestic and external arrears of the central government stood at 4.8 percent of GDP.

### 4.3.2 Management During 2001-2008

In 2001, a new administration took over the management of the economy and inherited a colossal public debt stock, domestic expenditure arrears worth 2.5 percent of GDP, and external arrears equal to 2.3 percent of GDP. The balance sheets of the energy and water SOEs—Tema Oil Refinery (TOR), Volta River Authority (VRA), Electricity Company of Ghana (ECG) and Ghana Water Company Limited (GWCL)—showed substantial liabilities on account of repressed pricing of their products. TOR had a total short-term debt of GH¢250 million, equivalent to 9.0 percent of GDP. About 80 percent of this debt, equal to GH¢200 million or 7.0 percent of GDP, was traced directly to unfunded subsidies on fuel products. The refinery had effectively defaulted on its debts, placing Ghana Commercial Bank (GCB), its main creditor, at risk of insolvency. VRA, ECG and GWCL were in similar financial dire straits for the same principal reason of unfunded subsidies and repressed pricing. The new government quickly pledged to retire the expenditure arrears through budgeted cash payments and to assume responsibility for the SOE debts that were linked to subsidies. The most concerning SOE was TOR, and the government decided to securitize its quasi-fiscal debts to give breathing space to GCB. Meanwhile, to avoid more subsidy arrears, it was announced that explicit allocations would be made in the budget to cover the cost of any future subsidies on fuel and utilities.

The government paid GH¢66.7 million, equal to 6.6 percent of total expenditure and 1.8 percent of GDP, in 2001<sup>14</sup> to clear almost all domestic arrears outstanding at end-2000. But it also incurred new road and non-road arrears worth more than 2.0 percent of GDP, with the non-road arrears occurring mainly as a result of delayed transfers to the DACF, GETFund and the Social Security and National Insurance Trust (SSNIT). The inability to quickly establish robust commitment controls was responsible for the new road arrears that accrued.

In 2002, a payment of GH¢81.2 million (1.7 percent of GDP) was made in respect of the built-up arrears in 2001, and the external debt service arrears outstanding at end-2000 were also eliminated. There were, however, unbudgeted salary awards in 2002, which were accommodated through a reduction of capital expenditure and a piling up of arrears to the DACF and GETFund. Road arrears of GH¢22.0 million (0.5 percent of GDP) were outstanding at the end of that year and transfers to the DACF and GETFund were in arrears of GH¢48.5 million, representing 1.0 percent of GDP.

In 2003, the government took a decision to retire the statutory fund arrears through equal annual payments (GH¢9.7 million per year) over five years beginning from 2003. It also pledged not to incur fresh arrears to the funds. For road arrears, a medium-term stock target of zero was set under the Poverty Reduction and Growth Facility (PRGF) program with the IMF. Following strong revenues in 2003, much of the end-2002 arrears were cleared through total payments of

<sup>13</sup>The DACF was set up in 1992 under the constitution and the government was mandated to transfer not less than 5 percent of its total annual revenue to the fund. The GETFund was created in August 2000, with 2.5 percent of the newly-increased Value Added Tax (VAT) rate of 12.5 percent earmarked for the fund.

<sup>14</sup>Due to limited stock data, the analysis of expenditure arrears from 2001 to 2007 relies largely on liquidation figures.

GH¢61.8 million (0.9 percent of GDP). The measured stock of road arrears at year-end was GH¢3.0 million (0.1 percent of GDP) and statutory fund arrears stood at GH¢38.8 million (0.6 percent of GDP).

While it was liquidating existing arrears, the government, under the auspices of the IMF, rolled out expenditure management reforms to prevent new arrears. These included an enhanced commitment control and cash management system, underpinned by quarterly expenditure ceilings and monthly cash limits, which was installed in all Ministries, Departments and Agencies (MDAs) by 2004. Monthly “fiscal early warning” reports were introduced to reinforce commitment controls and flag incipient overruns in expenditure. The automated Budget and Public Expenditure Management System (BPEMS), featuring a commitment control module and an accounts payable module, was operationalized in five ministries by end-December 2003, and by mid-2005, the number of ministries had been increased to 10 out of 38. Legislations such as the Financial Administration Act (and its accompanying regulations), the Internal Audit Act, and the Public Procurement Act were enacted during this period to strengthen public financial management.

By the end of 2003, there was a discernible decrease in the stock of arrears, reflecting the success of the strategy to retire statutory fund arrears, the progressive reduction of road arrears, and the partial success of the expenditure management reforms. An assessment of public expenditure management by the World Bank and the IMF in 2004 found only a “small stock” of arrears outstanding at end-2003 (IMF, 2004).<sup>15</sup> Indeed, expenditure on arrears in 2004 declined by 56.1 percent to GH¢27.1 million. This was equal to 1.0 percent of total government expenditure, compared with an average of 5.3 percent between 2001 and 2003.

By the end of 2004, all undisputed road arrears had been cleared (IMF, 2005) and the government had kept its pledge not to incur new statutory fund arrears (Government of Ghana Budget, 2005). But other arrears were created in 2004. Amounting to almost 1.0 percent of GDP, these were made up of deferred payment of unbudgeted wage and allowance increases, pension arrears, and delayed payment of subsidies to TOR to cover administered petroleum price losses. The clearance of these obligations in 2005 increased arrears expenditure to GH¢111.4 million, measuring 1.1 percent of GDP from 0.3 percent in 2004. If these obligations had not been incurred, arrears payment would have stabilized at 0.3 percent of GDP in 2005. In 2006, expenditure on arrears fell to GH¢48.8 million, equivalent to 0.3 percent of GDP and 1.2 percent of total expenditure.

From 2007-2008, expenditure on arrears remained low as a share of total expenditure and GDP. But there was a rise in the nominal outlays from GH¢48.8 million in 2006 to GH¢76.6 million in 2007 and GH¢142.3 million in 2008. This appeared to indicate an increased pace of arrears accumulation and coincided with the implementation of expansionary fiscal policies by the government after it came out of IMF supervision and monitoring in October 2006.<sup>16</sup>

<sup>15</sup>The stock was probably below 1.0 percent of GDP.

<sup>16</sup>The government’s second PRGF program came to a close in October 2006, and there was a considerable jump in the budget deficit afterwards, from 2.0 percent of GDP in 2005 to 4.8 percent in 2006 and 4.9 percent in 2007.



Part of the fiscal expansion was compelled by unfavourable external developments in 2007-2008, mainly the crises in the global food, financial and oil markets. Domestically, there were power shortages due to a drought in 2007-2008, which created the need for expenditures to mitigate the effects on the economy. But on the whole, expenditure control deteriorated, financial management reforms stalled, and fiscal indiscipline took hold again as the government faced a tight election battle in 2008. When it exited office after the elections, the domestic expenditure arrears which were discovered amounted to GH¢1.8 billion, equal to 6.0 percent of GDP. This was the largest stock of arrears (in both nominal and GDP terms) accumulated up until that time since the 1990s.

**Table 5: Arrears Payments, 2001-08**

Item	2001	2002	2003	2004	2005	2006	2007	2008
Arrears Payments (GH¢m)	66.7	81.2	61.8	27.1	111.4	48.8	76.6	142.3
o/w Road arrears	22.4	19.8	22.3	7.2	9.9	9.6	16.0	46.9
Non-road arrears	44.3	61.4	39.5	19.9	101.5	39.2	60.6	95.4
Payments as % of Expenditure	6.6	6.2	3.2	1.0	3.7	1.2	1.3	1.7
Payments as % of GDP	1.8	1.7	0.9	0.3	1.1	0.3	0.3	0.5
<u>Memorandum Items</u>								
Identified stock at year-end (GH¢m)	-	70.5	41.8	-	-	-	-	1,801.6
o/w Road arrears	-	22.0	3.0	-	-	-	-	125.1
Non-road arrears	-	48.5*	38.8*	-	-	-	-	1,676.5
Stock of arrears as % of GDP	-	1.5	0.7	-	-	-	-	6.0

Source: IMF, Ministry of Finance, Author's calculations \*Conservative estimates reflecting only statutory fund arrears

#### Management of the SOE Liabilities Taken Over by the Government

The government took over and restructured a large portion of TOR's debts by converting them to bonds. As at end-2002, GH¢240m of debts had been securitized, leaving around GH¢210m of short-term debt on the refinery's books. Another GH¢80m was securitized in 2003, raising the total liabilities extinguished from TOR's books to GH¢320 million. Many of the debts of VRA, ECG and GWCL were paid through budgetary transfers to these utilities, but these were not reported as arrears payments. From 2001-2005, the SOEs' financial situation improved, but it weakened again from 2006 with the fiscal deterioration that occurred and the return of unfunded price subsidies. The government thus left the SOEs in not much better state by the time it left office in 2008 than it had found them when it came to power in 2001.

#### 4.3.3 Management During 2009-2012

##### i. The Pre-Single Spine Era (2009-2010)

In 2009, the newly-elected government was confronted with a grim economic situation, underlined by large twin deficits, a rapidly-falling currency, surging inflation, high interest rates, and considerable government expenditure arrears, whose total stock was initially uncertain. The previous year's budget deficit on a cash basis was GH¢1.98 billion, equal to 6.6 percent of GDP (11.3 percent of non-rebased GDP) and up from GH¢1.13 billion or 4.9 percent of GDP (8.1 percent of non-rebased GDP) in 2007. Excluding net revenue from the divestiture of state assets, the 2008 budget deficit stood at GH¢2.56 billion, equivalent to 14.5 percent of non-rebased GDP.

In addition to the central government arrears, the energy SOEs, particularly TOR and VRA, had run up huge financial liabilities to banks and trade creditors. Much of the liabilities were linked to the government's arrears to the SOEs, made up of unserviced utility bills and unpaid price subsidies, which had weakened the SOEs' working capital positions and pushed them to borrow heavily from banks. Given the quasi-fiscal nature of the liabilities, and the fact that the affected SOEs were struggling to manage them, the government took over some of these debts with the view to retiring them as part of its arrears clearance strategy. Therefore, even though traditionally the coverage of government arrears has excluded SOEs' operational liabilities and arrears, some of these were added to the stock of arrears in 2010.

The arrears caused serious liquidity and solvency challenges for contractors and suppliers and contributed to pushing the banking industry's non-performing loans ratio into double digits. To address the problem, the government indicated an early commitment to liquidate the arrears and employed a strategy centred on two options: cash payments and securitization. The cash payments involved paying down the arrears out of current revenues or using proceeds from debt issues. The securitization option involved a rescheduling of some of the liabilities through direct issuance of bonds to the creditors. Borrowing to pay down the arrears had a direct effect on the cash deficit, while securitization directly increased the government's debt stock. Given these effects, the strategy of the government was to negotiate the appropriate option in each case with the creditors, taking into consideration its cash flow over the medium term, the possible inflationary impact of cash injection into the economy, and the extent of exposure of commercial banks to creditors, especially road contractors (Ministry of Finance, 2012).

A total cash payment of GH¢626.5 million, equal to 7.0 percent of total expenditure and 1.7 percent of GDP, was made in 2009 to reduce the stock of arrears. This was followed by a payment of GH¢551.2 million in 2010.<sup>17</sup> The stock did not necessarily shrink, however, as new arrears of GH¢923.7 million and GH¢1.2 billion were accumulated in 2009 and 2010 respectively, due principally to revenue shortfalls and higher-than-budgeted expenditure on wages and interest payments. In addition, the government embarked on a stock-taking exercise to ascertain the full magnitude of arrears and SOE-related contingent liabilities as at end-2010. After this exercise, SOE liabilities arising from short- and long-term loans and other commitments to creditors were identified and taken over by the government. This caused the total stock of arrears to be revised upwards to GH¢3.8 billion or 8.0 percent of GDP at end-2010. Excluding the SOE-related arrears and liabilities, the stock stood at GH¢2.0 billion or 4.4 percent of GDP (Table 6).

## ii. **The Emergence of Wage Arrears under the Single Spine Pay Policy**

Until 2010, the phenomenon of wage arrears did not exist on a significant scale in the public sector. In June of that year, however, the government started implementing the new Single Spine Pay Policy (SSPP) which had been initiated by the former administration. The goal of the SSPP was to correct inequities and distortions in public sector salaries and streamline pay administration. Its implementation involved a migration of public sector workers—except those listed under Article 71 of the 1992 Constitution, made up of the President, Ministers, Members of Parliament and Superior Court Judges—from the old Ghana Universal Salary Structure (GUSS) and other existing pay structures to a new unified pay structure, known as the Single Spine Salary Structure (SSSS). The SSSS had 25 vertical pay points, three more than the GUSS.

<sup>17</sup> In addition to this payment, the government made an equity injection of GH¢445 million into TOR to enable the refinery pay down its debts.

Though implementation of the policy began in June 2010, the government set January 2010 as the retroactive date on which new salaries determined under the SSSS were going to take effect. The migration of workers onto the SSSS was carried out in batches of MDAs and MMDAs (Metropolitan, Municipal and District Assemblies) between 2010 and 2012. Each time an MDA was moved onto the SSSS, the workers' new salaries corresponding to the new pay points on which they had been placed were determined. If a worker's salary on the SSSS was higher than the old salary, payment of the new salary was backdated to January 2010, and any difference between the new and old salaries up to the time of migration was recognized as arrears.

This arrangement gave rise to Single Spine wage arrears, which stood initially as implicit obligations but crystallized as the workers were placed on the new pay scheme. In 2011, the government paid GH¢343.4 million to clear wage arrears which had crystallized in 2010. In the 2012 Supplementary Budget presented to Parliament on July 18, 2012, the government announced that 99.3 percent of public sector workers had been migrated onto the SSSS as at May 2012, creating outstanding wage arrears of GH¢991 million (1.3 percent of GDP), which would be paid in the 2012 fiscal year (Government of Ghana, 2012). The amount was the budgeted wage arrears clearance for 2012 and was expected to fully extinguish the arrears stemming from the roll-out of the Single Spine Pay Policy.

Table 6: Stock of Arrears, 2008-11 (End of Period, GH¢ million)

Classification of Arrears	2008	2009	2010	2011
A. Projects	830.4	854.6	1,280.8	808.8
o/w Roads	125.1	187.5	312.1	0
Energy	581.2	489.3	422.7	407.9
Others	124.1	177.8	546.0	400.9
B. Statutory Funds/SSNIT/Services	301.2	574.2	748.0	281.0
o/w GETFund	49.1	101.0	141.8	38.8
DACF	35.1	172.3	116.7	0
National Health Fund	100.0	164.4	115.8	0
SSNIT	109.1	136.5	373.7	242.2
Services	7.9	0	0	0
C. Total (A+B)	1,131.6	1,428.8	2,028.8	1,089.8
% of GDP	3.7	3.9	4.4	1.8
D. Arrears to SOEs/SOE Liabilities	670.1	670.1	1,771.8	1,127.0
o/w Tema Oil Refinery (TOR)	444.1	444.1	1,256.9	567.7
Volta River Authority (VRA)	188.9	188.9	465.5	215.9
Others	37.1	37.1	49.4	343.4
E. Total Arrears (C+D)	1,801.7	2,098.9	3,800.6	2,216.8
% of GDP	6.0	5.7	8.0	3.7
Memorandum Items				
Wage Arrears (Single Spine)	-	-	343.0	991.0
Total Stock of Arrears (Including Wage Arrears)	1,801.7	2,098.9	4,143.6	3,207.8
% of GDP	6.0	5.7	9.0	5.4

Source: Ministry of Finance (Management of Arrears, December 2012)

Table 7: Arrears Payments and Securitizations, 2009-11 (GH¢ million)

Classification of Arrears	Annual Cash Payments				Securitization	
	2009	2010	2011	Total	2011	Total
A. Projects	361.8	374.8	614.4	1,351.0	-	-
o/w Roads	75.9	187.5	312.1	575.5	-	-
Energy	185.8	66.6	14.8	267.2	-	-
Others	100.1	120.7	287.5	508.3	-	-
B. Statutory Funds/SSNIT	264.8	176.4	524.3	965.5	223.7	223.7
o/w GETFund	49.2	20.0	141.8	211.0	223.7	223.7
DACF	35.1	24.2	116.7	176.0	-	-
NHIF	100.0	82.2	115.8	298.0	-	-
SSNIT	72.6	50.0	150.0	272.6	-	-
Others	7.9	0	0	7.9	-	-
C. Total (A+B)	626.5	551.2	1,138.7	2,316.5	223.7	223.7
% of GDP	1.7	1.2	1.9		0.4	0.4
D. SOE Liquidation	0	445.0a	366.5	811.5	572.3	572.3
o/w TOR	0	445.0a	116.9	561.9	572.3	572.3
VRA	0	0	249.6	249.6	-	-
Others	0	0	0	0	-	-
E. Total Payments	626.5	996.2b	1,505.2	3,128.0	796.0	796.0
% of GDP	1.7	2.2	2.5	2.2	1.3	1.3
<u>Memorandum Items</u>						
Wage Arrears Payments	-	-	343.4	343.4	-	-
Total Arrears Paid (incl. Wages)	626.5	996.2	1,848.6	3,471.4	-	-
% of GDP	1.7	2.2	3.1	2.4	-	-

Source: Ministry of Finance (Management of Arrears, December 2012) a. This reported payment was actually an equity injection by the government into TOR, which the latter used to settle some of its debts. b. Figure includes amount injected into TOR as equity. Everywhere else in this paper, this figure is excluded from arrears payments since it does not strictly qualify as such.

### iii. The Post-Single Spine Era (2011-2012)

In 2011, the take-off of oil production in Ghana, which increased real GDP growth to 14.0 percent, as well as strengthened tax administration gave a strong boost to domestic revenue mobilization. This helped the government to liquidate a substantial portion of the end-2010 stock of arrears of GH¢3.8 billion. The government made a cash payment of GH¢1.5 billion to clear part of the arrears and securitized GH¢796 million of the stock by issuing bonds to the creditors. The securitization comprised GH¢223.7 million of securities issued to SSNIT in lieu of deferred social security transfers and GH¢572.3 million of bonds issued to Ghana Commercial Bank (now GCB Bank) to replace liabilities of TOR to the bank. These steps slashed the end-2010 stock of arrears by 61 percent to approximately GH¢1.5 billion.

Adding the Single Spine wage arrears of GH¢343.4 million which were paid, the government's total cash expenditure on arrears in 2011 was GH¢1.8 billion or 3.1 percent of GDP, while the total securitization of GH¢796 million was equal to 1.3 percent of GDP. In total, arrears worth 4.4 percent of GDP were cleared in 2011 (Table 7).

New arrears totalling GH¢1.7 billion were however incurred in the same year, GH¢991.0 million of which were the Single Spine arrears expected to be paid in 2012, while the remaining GH¢717.4 million was composed of new project, statutory funds, and SOE arrears. Due to these developments, the end-2011 stock of arrears was GH¢3.2 billion (5.4 percent of GDP), of which GH¢2.2 billion (3.7 percent of GDP) were non-wage arrears. The implied net reduction in the stock of non-wage arrears between 2010 and 2011 was GH¢1.6 billion, which cut the ratio of non-wage arrears to GDP from 8.0 percent in 2010 to 3.7 percent in 2011. Thus the burden of arrears on the economy was reduced significantly, supporting a higher level of economic activity and a fall in the non-performing loans ratio of the banking system.

All along the government had been taking measures to arrest the build-up of new arrears. As a first step, a comprehensive database was created at the Budget Department of the Ministry of Finance to track the flow of arrears and report on it monthly to Cabinet. Enforcement of the requirement for MDAs to secure commencement certificates from the Ministry of Finance before committing the government to any expenditure on projects was intensified. Processes were also initiated to develop a Treasury Single Account (TSA) that would consolidate all government accounts and facilitate better cash flow and debt management. To improve cash flow forecasting, a cash management committee comprising central bank and Ministry of Finance officials was formed to monitor revenues, expenditures, and cash balances. A major reform in this period was the work which began on the Ghana Integrated Financial Management Information System (GIFMIS) to replace the erstwhile Budget and Public Expenditure Management System (BPEMS), which had stalled at the pilot stage under the former government.

Though necessary and beneficial, these reforms were not sufficient to prevent new arrears from being incurred in 2009-2011. The shortfalls in revenue and grants in 2009 and 2010 undermined the relatively improved expenditure control during this period, causing arrears to be accumulated. The implementation of the Single Spine Pay Policy from 2010 also weighed heavily on fiscal management as it led to a huge rise in the wage bill, while the retroactive salary awards created a large stock of wage arrears. The GIFMIS project also confronted initial financial and operational challenges, which delayed its roll-out and full implementation.

#### iv. **Developments in Arrears Management in 2012**

The clearance of arrears continued in 2012, with the government's revised budget for the year projecting a total expenditure of GH¢2.48 billion towards the settlement of wage and non-wage arrears (Table 8). This planned expenditure was equal to 77.4 percent of the GH¢3.2 billion stock of arrears outstanding at end-2011. There are, however, conflicting figures on the actual arrears paid in 2012. First, according to the government's 2013 budget, a total amount of GH¢3.7 billion was used to pay arrears in the 2012 fiscal year (Table 8). But in a document titled *The Arrears Clearance Strategy*, which was retrieved from the Ministry of Finance website on May 28, 2015, the reported expenditure on arrears in 2012 is a much lower figure of GH¢420.8 million, and it is also indicated that an additional GH¢203.1 million of arrears was securitized (Table 9).<sup>18</sup>

<sup>18</sup> The Ministry of Finance did not address a formal request to reconcile this discrepancy.

Table 8: Budgeted and Actual Expenditure on Arrears, 2012 (GH¢ million)

Breakdown of Arrears	2012 Budget Estimates	2012 Revised Budget	2012 Actual	Deviation: Actual v Revised	Deviation in Percent
A. Road Arrears	250.0	250.0	359.8	109.8	43.9%
B. Non-Road Arrears	1,141.0	2,233.8	3,306.3	1,072.5	48.0%
o/w Wage Arrears	991.0	991.0	1,872.0	881.0	88.9%
DACF	0	0	0	0	0%
GETFund	0	38.8	38.8	0	0%
Other deferred payments	150.0	1,204.0	1,395.4	191.4	15.9%
C. Total Arrears (A+B)	1,391.0	2,483.8	3,666.1	1,182.3	47.6%
Memorandum Item					
Total Non-Wage Arrears	400.0	1,492.8	1,794.1	301.3	20.2%

Source: Government of Ghana Budget and Supplementary Budget Statements (2012; 2013)

Table 9: Arrears Payments and Securitizations, 2009-12 (GH¢ million)

Item	2009	2010	2011	2012
Payments	626.6	996.2 <sup>a</sup>	1,505.2 <sup>b</sup>	420.8
Securitization	-	-	796.0	203.1

Source: Ministry of Finance (The Arrears Clearance Strategy, retrieved on May 28, 2015 at <http://www.mofep.gov.gh/?q=news/140613>) a. Includes GH¢445 million equity injection into TOR  
b. Excludes wage arrears payments

There are also differences between end-2012 stock-of-arrears data from the Ministry of Finance's 2013 Budget Framework Paper, which was issued internally on January 25, 2013 to inform the preparation of the 2013 budget, and figures in The Arrears Clearance Strategy document. In the former document, the outstanding stock of arrears in 2012 that was expected to be carried over to 2013 was GH¢5.4 billion (Table 10), whereas in the latter document the outstanding stock for the same period was stated as GH¢2.3 billion (Table 11). Among the arrears identified in the Budget Framework Paper were outstanding bills totalling GH¢984.6 million, which were being held at the Ministry of Finance and the Controller and Accountant-General's Department (CAGD) but were not reported in The Arrears Clearance Strategy document.

Table 10: End-2012 Outstanding Government Expenditure Arrears (I)

Item	Amount (GH¢m)
Road Arrears	250.0
Non-Road Arrears	5,110.4
o/w Outstanding bills at CAGD	510.0
Outstanding bills at MoFEP	474.6
Indebtedness to utility companies	249.2
Social Security	363.4
Fuel subsidies	360.0
DACF, GETFund, NHF	454.4
Cocobod	857.6
Domestic interest	223.4
Promissory notes issued for waste management	270.4
Single Spine wage arrears	42.0
Stock of arrears from 2008-2011	1,305.8
Total Road and Non-Road Arrears	5,360.4
% of GDP	7.1

Source: Ministry of Finance (Budget Framework Paper, January 2013)

Table 11: End-2012 Outstanding Government Expenditure Arrears (II)

Item	Amount (GH¢m)
Energy	359.8
Interest Payments	223.4
GETFund, DACF, NHF	300.0
Utilities	333.0
Others	258.5
SOEs	862.0
o/w TOR	304.2
VRA	149.9
BOST	49.4
Cocobod	358.5
Total Stock of Arrears	2,336.7
% of GDP	3.1

Source: Ministry of Finance (The Arrears Clearance Strategy, retrieved on May 28, 2015 at <http://www.mofep.gov.gh/?q=news/140613>)

There were further confounding developments in reported expenditure on arrears in 2012. Table 12 shows government revenue and grants, expenditure, arrears clearance, and budget deficit outturns for the first three quarters of 2012, as published by the Ministry of Finance in the last quarter of 2012. According to the table, arrears paid in the first three quarters was GH¢2.3 billion, of which GH¢1.1 billion was expenditure on wage arrears. Total expenditure including arrears clearance was GH¢15.8 billion, with a budget deficit of GH¢5.1 billion or 7.1 percent of GDP.

Table 13 shows the fiscal outturn for the whole of 2012 on a quarterly basis. This information was published in the first quarter of 2013. It shows that almost all the indicators for the first to third quarters of 2012, which had been published earlier in 2012, were revised significantly when the full-year results were reported in 2013. In the revised data, arrears cleared in the first three quarters was GH¢2.9 billion, a difference of more than GH¢600 million, or 27 percent, over the earlier reported figure of GH¢2.3 billion. The additional reported arrears payments represented 55 percent of the total adjustment of GH¢1.1 billion which was made to total expenditure in the first three quarters of 2012. The budget deficit for the first three quarters was adjusted upwards by GH¢520.4 million, or 10.2 percent, to GH¢5.6 billion, an increase of 0.7 percent of GDP.

Table 12: Government of Ghana Fiscal Outturn, Q1-Q3 2012 (GH¢ million)

Indicator	Q1	Q2	Q3	Q1-Q3
Total Revenue and Grants	3,705.0	3,887.0	3,531.2	11,123.1
Total Expenditure (Excluding Arrears Clearance and Tax Refunds)	3,915.9	4,458.8	5,041.2	13,415.9
Arrears Clearance	1,310.5	667.9	285.7	2,264.1
o/w Road arrears	0	0	0	0
Wages	380.7	667.9	83.4	1,132.0
DACF	0	0	0	0
GETFund	38.8	0	0	38.8
Others	891.0	0	202.3	1,093.3
Tax Refunds	40.9	34.5	15.2	90.6
Total Expenditure, Arrears Clearance and Tax Refunds	5,267.3	5,161.2	5,342.1	15,770.6
Budget Deficit	978.9	2,739.6	1,369.0	5,087.5
% of GDP	1.4%	3.8%	1.9%	7.1%

Source: Ministry of Finance [Published during last quarter of 2012]

Table 13: Government of Ghana Fiscal Outturn, Q1-Q4 2012 (GH¢ million)

Indicator	Q1	Q2	Q3	Q1-Q3	Q4	Q1-Q4
Total Revenue and Grants	3,924.8	4,146.6	3,722.3	11,793.6	4,874.8	16,668.4
Total Expenditure (Excluding Arrears and Tax Refunds)	4,321.4	4,663.1	4,910.5	13,895.0	6,694.7	20,589.7
Arrears Clearance	1,461.2	877.3	536.2	2,874.7	791.4	3,666.1
o/w Road arrears	0	0	0	0	359.8	359.8
Wages	480.1	862.3	333.8	1,676.2	195.9	1,872.0
DACF	0	0	0	0	0	0
GETFund	38.8	0	0	38.8	0	38.8
Others	942.4	15	202.3	1,141.7	595.5	1,737.2
Tax Refunds	40.9	39.5	40.6	121.0	42.7	163.7
Total Expenditure, Arrears Clearance and Tax Refunds	5,823.5	5,579.9	5,487.3	16,890.7	7,528.8	24,419.5
Budget Deficit	1,056.6	2,872.1	1,679.2	5,607.9	3,107.5	8,715.4
% of GDP	1.5%	4.0%	2.3%	7.8%	4.3%	12.1%

Source: Ministry of Finance [Published during first quarter of 2013]



These wide revisions in arrears payments data and the conflicting stock figures point to serious measurement and reporting issues that have cast a shadow of opacity on the evolution of expenditure arrears from 2012, making it difficult to gauge the success of the government's arrears management program since that period. The conflicting data also hint at the problems which arise because the government does not have—and does not apply—a fixed definition of arrears.

#### 4.3.4 Management During 2013-2015

The backdrop to fiscal management in 2013 was a large budget deficit—11.6 percent of GDP—recorded in 2012 due to expansionary fiscal policies, and new payment arrears caused by a substantial weakening of expenditure controls. The amount of these new arrears, according to the 2013 Budget Framework Paper, was GH¢4.1 billion. Adding this figure to outstanding arrears from 2008-2011 of GH¢1.3 billion, the Budget Framework Paper estimated the total stock of arrears as at end-2012 to be GH¢5.4 billion, representing 7.1 percent of GDP. As previously shown, other data from the Ministry of Finance put the end-2012 stock of arrears at GH¢2.3 billion, equivalent to 3.1 percent of GDP. What the actual stock of arrears was is therefore uncertain.

Meanwhile, fiscal management in 2013-2015 has been characterized by the payment of huge arrears and additional arrears creation, especially in 2013 and 2014. In 2013, the government spent GH¢2.2 billion (7.3 percent of total expenditure and 2.3 percent of GDP) to clear arrears, half of it to settle deferred wages (Table 15).<sup>19</sup> Meanwhile, new arrears were accumulated in the year, mostly on account of an acute underperformance of fiscal revenues, which was not adequately mitigated by expenditure restraint. Appreciable shortfalls in transfers to statutory funds, particularly the GETFund, DACF and social security fund, led to the build-up of more arrears to these funds. In 2014, there was part clearance of arrears to GETFund and DACF, while arrears to the social security fund of GH¢914 million (0.8 percent of GDP) were securitized. An amount of GH¢567.6 million was also used to settle wage arrears. In total, cash arrears clearance in 2014 stood at GH¢3.2 billion, equal to 8.9 percent of total expenditure. But new arrears continued to recur, including on energy subsidies, which had been cut after 2012 but not completely eliminated, and statutory fund obligations. As in 2013, lower-than-budgeted revenue, which was not sufficiently offset by reduced expenditure, contributed to the build-up in arrears.

In April 2015, the government estimated its total stock of arrears as at end-2014 to be GH¢6.2 billion (5.5 percent of GDP). The bulk of these was concentrated in the SOEs and statutory funds (IMF, April 2015). The arrears also included audited petroleum subsidy arrears owed to private sector bulk oil distribution companies (BDCs).<sup>20</sup> Under a new strategy outlined in the government's ongoing financial and economic program with the IMF, the arrears are planned to be cleared over 2015-17, with an additional program requirement that no new arrears be accumulated within the period. The government has also committed to structural fiscal reforms to stem the recurrence of arrears. At the core of the reforms is the passage of a new public financial management law with provisions to strengthen budget formulation and execution; improve treasury management, accounting and reporting; and specify sanctions against public officials for breaches of the legislation and general financial misconduct.<sup>21</sup>

<sup>19</sup>None of the published data on arrears outstanding as at end-2012 indicated the existence of a large quantity of wage arrears. It is difficult, therefore, to reconcile the wage arrears clearance in 2013 with any stock data on arrears, bringing to the fore, once again, concerns about the credibility of arrears stock and clearance information published by the Ministry of Finance.

<sup>20</sup>The government had initially disputed part of the BDCs' claims for foreign exchange and underpricing losses related to past petroleum subsidies and had excluded these claims from its arrears.

<sup>21</sup>The new legislation, Public Financial Management Act (Act 921, 2016), was passed in August 2016.

One of the main lessons from past reform efforts which can be applied to this latest attempt is that, although an improved legal framework is critical for addressing public financial management failures, reforms do not succeed without sustained political commitment and rigorous implementation of the improved legislation and policies.

Table 14: Arrears Clearance, 2013-15

Item	2013	2014	2015
Total Arrears Payments (GH¢m)	2,170.9	3,166.2*	2,698.7
o/w Road arrears	205.1	231.7	549.6
Non-road arrears	1,965.8	2,934.5	2,149.1
o/w Wage arrears	1,065.0	567.6	805.7
GETFund	0	476.1	100.4
DACF	0	360.2	441.9
Other deferred payments	900.8	1,530.6	801.1
Arrears Payments as % of Total Exp.	7.3	8.9	6.7
Arrears Payments as % of GDP	2.3	2.8	1.9
Memorandum Item			
Year-End Outstanding Stock of Arrears (GH¢bn)	-	6.2	-

Source: Ministry of Finance, IMF (April 2015) \*Excludes securitized SSNIT arrears of GH¢914m

## 5.0 Observations

The discussion so far has brought forward a number of key issues associated with the problem of arrears in Ghana. The first concerns definitional and measurement difficulties that call into question the integrity of some of the arrears data and invite a bit of caution when appraising them. The second is the seeming intractability of the arrears problem, as it has been shown that despite past efforts to eradicate it, the problem has not only been recurring but increasing in recent years, with the government still planning to retire GH¢4.6 billion in arrears during 2016-2017 (See Government of Ghana Budget Statement and Economic Policy for the 2016 Financial Year). This leads to the third important issue, which has to do with the need for comprehensive public financial management reforms to address the fundamental factors behind the recurrence of expenditure arrears.

### 5.1 Definitional and Measurement Issues

As noted in Section 3, the lack of a clear definition that is applied consistently to describe and measure the stock of arrears is an obstacle to obtaining accurate data on the problem. It also means that any comparison of arrears data over several periods would have to be qualified by reference to the underlying definitions and scope of coverage, which may differ across time. For instance, after 2009, the coverage of arrears was expanded to include certain SOE obligations, which was not the case previously. This contributed to the escalation in identified arrears and corresponding growth in payments.

Another risk in not having a consistent or transparent definition is that official arrears data could potentially overstate or understate the real size of the problem. This appears to be the case with the 2012 arrears clearance, which has been reported as two different amounts—GH¢3.7 billion and GH¢420.8 million. If indeed accurate, the higher figure of GH¢3.7 billion, against a stock

outstanding at end-2011 of GH¢3.2 billion (see Table 6), would suggest that the actual stock of arrears outstanding at end-2011 was understated. On the contrary, the lower figure of GH¢420.8 million indicates parallel reporting that raises doubts about whether the purported GH¢3.7 billion arrears clearance in 2012 represents the true arrears expenditure in that year.

Contradictory reports on the end-2012 stock of arrears (see Tables 10 and 11), as well as the inability to reconcile certain post-2012 arrears payments—for example, on wages—with pre-existing stock data, also hint at persisting inconsistencies in the measurement and reporting of arrears, inhibiting an accurate assessment of how actual arrears have evolved after 2012.

## 5.2 The Seeming Intractability of the Arrears Problem

The second key observation from this paper is that payment arrears have become routine and pervasive in the public financial management system and have risen substantially in recent years. Every financial year since 1992 has ended with the accumulation and payment of some arrears. In addition, virtually all categories of government expenditure—wages, transfers and grants, debt service, goods and services, and investment or assets—have suffered from arrears over the years. This is in spite of several actions taken to deal with the arrears problem. It would therefore appear that the problem has become intractable, or that arrears have gained acceptability among officials as a normal outcome of the expenditure process.

Arrears payment—which often reflects the size of past accumulated arrears—has also increased considerably since the end of 2008, making it a strong driver of government expenditure in recent years. Total arrears paid during 2009-2012 was GH¢6.7 billion,<sup>22</sup> which was considerably bigger than the payments in 2001-2004 and 2005-2008, which were GH¢236.8 million and GH¢379.1 million respectively. The portion of government expenditure which went into retiring arrears was also significantly higher in 2009-2012, at 10.9 percent of total spending, compared with 3.4 percent in 2001-2004 and 1.8 percent in 2005-2008. In terms of GDP, the government spent three times more during 2009-2012 to pay arrears than in 2001-2004 and six times more than in 2005-2008.

In spite of this huge arrears liquidation between 2009 and 2012, expenditure on arrears remained at a high level after 2012, with a total of GH¢8.0 billion paid in 2013-15. This was equivalent to 7.7 percent of total government expenditure and 2.3 percent of GDP in the same period. Despite these ratios being lower than in 2009-2012, the levels remain significantly higher than before 2009.

Although two policy changes—the inclusion of SOE liabilities in arrears and the new public sector wage policy—contributed to the substantial arrears payments in 2009-2015, when the figures are adjusted to exclude these components (see Figure 4), the picture that still emerges is one of a sharp increase in expenditure on arrears, both in nominal terms and relative to total government expenditure and national income during the period.

It is thus clear that the incurrence and clearance of arrears reached significant new heights after 2008, and that, relative to earlier times, arrears payments contributed more substantially to overall government expenditure during this period.

<sup>22</sup> The 2012 figure used in the calculation is the GH¢3.7 billion reported in the 2013 budget statement. If the competing figure of GH¢420.8 million is used, the total arrears paid in 2009-2012 comes to GH¢3.9 billion, which is still much larger than in the earlier periods.

### 5.3 Lack of Durable and Comprehensive Public Financial Management Reforms

Generally, a government may sometimes accumulate arrears to manage the impact of a shock to its revenues or the market in which it borrows. These temporary arrears can be settled once this setback is overcome, or as borrowing conditions improve. On the contrary, recurring arrears, as is the case in Ghana, signal underlying weaknesses in public financial management, in particular shortcomings in budgetary planning and execution, the resolution of which is essential to make inroads into the problem.

Although governments in Ghana have implemented reforms to address these weaknesses over the years, arrears have not only persisted but also increased. This is down to two main reasons: the reforms to the public financial management system have not been comprehensive and, in many cases, specific reforms were partially or weakly implemented—sometimes because the required political will and support was not sustained long enough for the reforms to last.

Two examples can be cited. First, although multi-year budgeting was introduced in 1999 to enable the budget take cognizance of financial commitments beyond a single financial year, the system has been plagued by poor and unreliable medium-term estimates, which often means there is inadequate provision for future expenditure commitments, increasing the possibility of accumulating arrears on the obligations that mature from those commitments.

Second, the legal framework for public financial management, which was strengthened with the enactment of the Financial Administration Act and its accompanying regulations in 2003-2004, has proven inadequate in checking some of the financial malpractices—such as illegal awarding of contracts—that give rise to arrears. This is largely because the legislation and regulations were not backed by a sanctions regime to make them effective in checking financial misconduct.

The next section concludes the paper with policy recommendations to address some of the identified shortcomings that seem to perpetuate arrears in Ghana.

## 6.0 Conclusion and Policy Recommendations

This paper has demonstrated the prevalence of expenditure arrears in government fiscal operations in Ghana. It has also shown the rapid growth of arrears payments and its contribution to high aggregate government expenditure in recent years. Payment arrears evolved from being mostly foreign in nature in the 1970s-80s to predominantly domestic arrears since the 1990s. Domestic arrears were initially confined to the road sector but spread to other sectors from 1999. Over the years, arrears have not been defined in a consistent manner, with the effect that the arrears identified at any point in time may not always reflect the definition that was previously applied to the concept.

This notwithstanding, arrears rose to higher prominence after 2008, with appreciable stock and clearance amounts recorded in 2009-2012. Some of these were legacy bills from 2008 and contingent liabilities of the government that were weighing down the operations of some strategic SOEs. The trend of huge arrears clearance has continued after 2012, with the outstanding stock estimated at GH¢6.2 billion in 2014 and expected to be retired over 2015-2017.

The plan by the government to eliminate existing arrears using cash payments and securitizations is appropriate. However, there should be greater transparency about the strategy through the provision of adequate and comprehensive information on arrears in the budget. In addition, to enhance the credibility of the data in the light of the inconsistencies pointed out in this paper, the standard for identifying or measuring arrears should be made known. This will assist a more accurate appraisal of how arrears have evolved, how they are being managed, and what weaknesses may need to be addressed.

More crucial, however, is the need to tackle the fundamental causes of arrears, which are systemic failures in the public financial management system, in particular a weak budgetary framework that makes arrears an almost inevitable outcome of the budget execution process. To achieve this, the following reforms are recommended.

### **Overhaul of Budget Planning and Preparation**

Reform of the budgetary process is a key prerequisite for preventing arrears. Among others, the following critical steps must be taken:

- *Formulation of realistic budgets:* To stem the recurrence of arrears, the realism of the budget ought to be improved. A credible macro-fiscal framework needs to be in place to provide the basis for robust forecasts of macroeconomic and fiscal indicators, especially government revenue and expenditures. Improved human resource capacity and better forecasting tools are essential to enhance the credibility of revenue estimates. With regard to expenditure, the projections need to be determined more realistically through adequate costing and budgeting for MDAs' programs and projects, and timely negotiation of public sector wages to ensure that the full expected cost of compensation is incorporated in the budget. If revenue and expenditure forecasts are brought closer to reality, the probability of incurring overruns and arrears would be minimized, guaranteeing better control of the budget.
- *Ensuring credible medium-term planning and greater certainty of medium-term targets:* A more credible medium-term budget framework is required to ensure greater predictability of the flow of resources over the medium-term. This will facilitate adequate budgeting for expenditures which take place within a multi-year period, such as the outlays on big capital projects. A credible medium-term budget framework will also assure of the medium-term fiscal capacity to finance expensive multi-year projects before they are embarked upon.
- *Minimising earmarks:* Legislative earmarks, which constrict the government's discretionary control of expenditure, have to be thoroughly reviewed. Earmarks have to be scaled down to expand the scope for effecting in-year expenditure adjustments to accommodate budget implementation risks. This will also reduce incentives to accumulate arrears in an attempt to mitigate budgetary inflexibility.

### **Strengthening Budget Execution**

Better budget execution will support the control and prevention of arrears. The following should be done:

- *Strengthening expenditure monitoring and commitment controls:* Effective monitoring must be carried out at all stages of the expenditure cycle, right from the incurrence of commitments to the making of payments. Expenditure monitoring must be backed by the establishment and enforcement of strong commitment controls that prevent spending units from exceeding their budget ceilings when they initiate expenditure. The GIFMIS system currently being deployed in the MDAs has commitment-control capabilities, since it mandates the generation of commitment numbers for suppliers and contractors at the commitment stage of expenditure. The commitment numbers provide assurance that the expenditure that has been initiated has been adequately provided for in the budget. But GIFMIS only processes inputs and can be circumvented by officials who fail to process commitments through the system. It is therefore important to shore up GIFMIS' functionalities with rigorous human oversight and a sanctions regime that penalizes the circumvention of agreed procedures.
- *Enhancing budget reporting and accounting:* Timely reports should always be provided on commitments, outstanding obligations, and payments. "Early warning reports" must be generated regularly to inform quick responses to incipient challenges with payments. The limitations of the cash accounting system, under which expenditures are recorded only when cash is paid, need to be addressed by a supplementary reporting system for commitments, payables, and arrears. It should be possible for the government to provide a comprehensive report in the budget on all its outstanding liabilities in each financial year using this supplementary reporting system. The treatment of arrears payments in the fiscal accounts should also be reviewed. As an alternative, the GFSM-based reporting format presented in this paper can be adopted.
- *Improving cash management:* The Ministry of Finance must ensure that reliable cash forecasts are used to set monthly or quarterly expenditure ceilings. MDAs must develop their own cash plans and submit them to the Ministry to be included in overall cash planning.
- *Curbing payment processing delays:* Delays in processing payments must be dealt with by establishing clear timelines for processing of invoices through the various stages of payment. Sanctions should be applied if these timelines are breached without reasonable cause. Heads of institutions must be held responsible for late submission of the particulars of new recruits for processing into the personnel and payroll database.

### **Strengthening the Legal and Regulatory Framework**

There are two strands of reforms required in this direction. First is that the legal and regulatory framework governing public financial management must be amended or strengthened to incorporate rules on payments, including a clear description of the stages of payment, timelines for processing and effecting payments for expenditure incurred, and a clear definition of what constitutes expenditure arrears under each expenditure category. This will make it easier to identify actual arrears payments and resolve the ambiguities surrounding the reporting of arrears expenditure.

The second strand of required legislative reforms is the institution of legally-backed and strongly enforced sanctions to penalize—and therefore deter—behaviour by public officials that results in unauthorized financial obligations for the government. The absence of this was a major weakness in the Financial Administration Act (FAA) that undermined its effectiveness in preventing financial misconduct that gives rise to arrears. The Public Financial Management Act passed in August 2016 to replace the FAA has, to a large extent, plugged this loophole by specifying tough sanctions for various forms of misconduct and non-compliance. For the legislation to be effective, however, sanctions must be enforced strictly and fairly, whether offenders are politicians or bureaucrats.

### **Political Commitment to Reforms and Strengthening Parliamentary Oversight**

No effort to reform Ghana's public financial management system and ensure sustainable fiscal management can succeed without political commitment to the reform process. If political commitment is not secured, support and adequate resources are not likely to be provided to achieve the objectives of the reforms.

Politicians, like bureaucrats, should be bound by expenditure controls, the general constraints of the budget, and the financial laws of the public sector. Unfunded energy subsidies, which normally produce huge arrears to SOEs, must be avoided, and subsidies should be replaced with well-targeted social transfers.

As the arm of government entrusted with oversight of the public financial management system, Parliament must be better resourced, both technically and financially, to improve its monitoring of the public finances to ensure compliance with applicable rules and regulations, and fiscal sustainability principles.

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