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Mid-Year Review of the 2018 Budget Statement & Economic Policy Comments from the IFS

1.0 Introduction

On July 19, 2018, the Minister of Finance presented to Parliament the Government's Mid-Year Fiscal Policy Review of the 2018 Budget Statement and Economic Policy. According to the Minister of Finance, the overarching goal of government's macro-fiscal policy is to deepen macroeconomic stability, grow the productive sectors of the economy, create jobs and ultimately move the economy beyond aid. Consequently, the government's fiscal policy has been designed to reduce the fiscal deficit to ensure debt sustainability without compromising growth. It has also been designed to be growth friendly, reformative and flexible to enable a quick adaptation to an evolving economy.

The Institute for Fiscal Studies (IFS) has reviewed the Government's Mid-Year Review of the 2018 Budget and Economic Policy. The review, presented below, focuses on four thematic issues: an overview of recent macroeconomic performance; fiscal performance and adjustments to the fiscal framework; observations and comments; and conclusions.

2.0 Macroeconomic Performance

Ghana's real GDP growth began to rise in 2017 with a rate of 8.5%, after dropping sharply to 3.7% in 2016. Real GDP (including oil) grew by 6.8% in the first quarter of 2018, compared to 6.7% recorded in the same period of 2017, and is projected to remain at 6.8% in 2018. Compared to 8.1%

growth in December 2017, however, shows a drop in growth in the first quarter of this year. The rebound in real GDP growth during the first quarter of 2018 is more broad-based as the contribution of the oil sector is tapering off, while industry and services growth are picking up strongly. The industry sector recorded the highest growth rate of 9.6% during the first quarter of 2018, compared to 11.8% in the same period in 2017, both of which were below the 17.5% growth recorded in December 2017. Growth of the services sector picked up to 5.2%, higher than the 3.3% recorded in the same period in 2017 and 3.4% recorded in December 2018. The growth of agriculture during the first quarter of 2018 was not encouraging. The sector grew by 2.8%, compared to the 8.4% recorded in the same period in 2017 and 8.5% recorded in December 2017.

The trend decline in inflation observed in 2017 continued into the first four months of 2018. Headline inflation dropped from 11.8% in December 2017 to 9.6% in April 2018, and thereafter edged up reaching 10% in June. The upward movement after April was driven mainly by the upward adjustment of ex-pump prices of petroleum products following the rising international crude oil prices which led to increase in administered transport prices.

The foreign exchange market remained calm during the first quarter of 2018 on the back of subdued demand pressures and improved foreign exchange liquidity. The cedi-dollar exchange rate in the interbank market remained stable at GH¢4.42 between December 2017 and February 2018, and dropped to GH¢4.40 in March. Cumulatively, the cedi appreciated by 0.2% against the US dollar during the first quarter of 2018, compared with a depreciation of 5.0% during the same period in 2017. The cedi however saw some unsteadiness in the second quarter, losing ground to the US dollar and promoting fears that the local currency was back to its perennial poor performance against the dollar. Beginning in April, the cedi-dollar exchange rate began to rise, reaching GH¢4.52 in June. In the year to mid-July, the cedi cumulatively depreciated by 5.8% against the dollar, compared to 3.9% observed during the same period in 2017. The dollar performed strongly on the international currency market during the May-June period, supported by the normalization of US monetary policy and the uplift of the country's interest rate for the second time this year. This led to a reverse capital flows in a number of emerging market and frontier economies, including Ghana (BoG, July 2018).

The external sector performed strongly during the first half of 2018, buoyed by higher export earnings from oil and a moderation in imports. As a result, the trade account posted a surplus of US$1,101.0 million, although lower than the surplus of US$1,128.7 million recorded in the same period of 2017. Oil exports amounted to US$2,131.8 million during the period, compared to US$1,242.5 million posted in the same period of 2017, driven mainly by the increase in price. The average price of crude oil rose to US$70.38 per barrel during the first half of 2018 compared to US$53.02 in the same period of 2017. Both cocoa and gold export earnings were lower during the first half of this year compared with the earnings in the same period of last year as a result of lower export volume. It is reported that nontraditional exports increased during the first half of 2018, but no details were provided by the Government. Imports of merchandise goods were up by 9.7% to US$6,661.2 million during the period, from US$6,069.5

million recorded in the same period in 2017, mainly due to the increase in both oil and non-oil imports. Gross international reserves dropped by US$260.7 million to US$7,294.1 million at end June 2018, from US$7,554.8 million at the end of December 2017. This was sufficient to cover 3.9 months of imports, compared to 4.3 months in December.

3.0 Fiscal Performance and Revisions to the Fiscal Framework

Fiscal performance during January-May 2018 was not encouraging. The period saw a drop in both revenue and expenditure in relation to their targets for the period, with the revenue fall being much bigger than the drop in expenditure. Total revenue and grants amounted to GH¢17.4 billion (7.2% of GDP) during the period, representing 34.1% of the annual budget target and GH¢1.4 billion (7.6%) below the target for the period (see Table 1). Disappointingly, with the exception of revenue from taxes on income and property that exceeded its target, all the other revenue lines fell short of their budget estimates, with the largest shortfalls recorded for revenue from taxes on domestic goods and services and non-tax revenue.

The trend for government expenditure during the period was not different from that of revenue. Total expenditure (including arrears clearance) amounted to GH¢23.8 billion (9.8% of GDP), constituting 38.3% of the annual budget and 3.2% lower than the target of GH¢24.6 billion for the period. Interest payment was cut by GH¢335.3 million (5.5%), while spending on wages and salaries increased by GH¢279.6 million (4.1%) and goods and services also increased by GH¢134.1 million (9%). Capital expenditure and interest payment experienced significant cuts while expenditure on wages and salaries, and goods and services recorded overruns. Capital expenditure was cut by GH¢972.2 million (39.6%), with domestic-financed capital expenditure carrying the brunt of the cut. Domestic-financed capital expenditure was cut by GH¢687 million (61%), accounting for 70.7% of the cut in total capital spending (see Table 1).

The fiscal operations resulted in a deficit (including divestiture and discrepancy) of GH¢6.4 billion (2.6% of GDP) during January-May 2018, which was higher than the target of GH¢5.7 billion (2.4% of GDP). Due to lower revenues for the period, the primary balance also resulted in a deficit of 0.4% of GDP against a target of 0.2% of GDP (see Table 1). The deficit was financed from net foreign resources of GH¢4,101.0 million, representing 64.4% of total financing (compared with a programmed amount of -GH¢419.2) and net domestic resources of GH¢3,084.5 million, representing 35.6% of total financing (compared to the programmed amount of GH¢6,554.5 million).

Table 1. Fiscal Performance, January-May 2018

	Programmed GH¢' m	% of GDP	Provisional Outturn GH¢' m	% of GDP	Variance GH¢ 'm	%
Total Revenue and Grants	18,813.5	7.8	17,384.7	7.2	-1,428.0	-7.6
Domestic Revenue	18,608.1	7.7	17,005.0	7.0	-1,603.1	-8.6
Tax Revenue	14,758.7	6.1	13,851.6	5.7	-907.1	-6.1
Non-Tax Revenue	2,832.4	1.2	2,396.1	1.0	-436.3	-15.4
Grants	205.4	0.1	379.7	0.2	174.3	84.9
Total Expenditure	24,158.1	10.0	22,608.1	9.4	-1,550.0	-6.4
Wages and Salaries	6,852.0	2.8	7,131.6	3.0	279.6	4.1
Interest Payments	6,113.7	2.5	5,778.4	2.4	-335.3	-5.5
Goods and Services	1,492.6	0.6	1,627.0	0.7	134.4	9.0
Transfers to Other Gov. Units	4,498.3	1.9	4,364.7	1.8	-133.6	-3.0
Capital Expenditure	2,452.9	1.0	1,480.7	0.6	-972.2	-39.6
Domestic-Financed	1,125.4	0.5	438.4	0.2	-687.0	-61.0
Arrears	-394.9	-0.2	-807.4	-0.3	-412.5	104.5
Overall Balance (incl. div. discrepancy)	-5,739.5	2.4	-6,371.8	-2.6	-632.3	11.0
Primary Balance	374.1	0.2	-593.4	-0.2	-967.5	-258.6
Memorandum Item						
Oil Revenue	1,544.2	0.6	2,104.0	0.9	559.8	36.2
Non-Oil revenue	17,269.3	7.1	15,280.7	6.3	-1,988.6	-11.5
Annual Budget Funding Amount (ABFA)	794.2	0.3	1,030.7	0.4	236.5	29.8

Source: Government of Ghana (July 2018)

Reasons provided by the Government for the revenue shortfall during January-May 2018 include:

- Lower import VAT due to lower CIF values;
- Increase in re-exports of warehoused products;
- Lower VAT/NHIL receipts from telecommunication companies;
- Delays in tax stamp implementation;
- Admittance of large volumes of imports into exempt or low tariff categories; and
- Lower reported MDA's IGF retention.

According to the Government, if the revenue and expenditure trends recorded during January- May 2018 continue without new policy measures or remedial actions, the year will end with a total revenue of GH¢49,610.4 million, which is GH¢1,428.7 million (2.9%) lower than the original target of GH¢51,039.1 million. Total expenditure (including net change in arrears clearance) at the end of the year will also be GH¢61,451.6 million, which is GH¢558.7 million (0.9%) lower than the original target of GH¢62,010.3 million. The resulting fiscal deficit will then rise to GH¢11,841.2 million (4.9% of GDP), which will be GH¢870 million (0.4% of GDP) more than the original target of GH¢10,971.1 (4.5% of GDP), delaying the fiscal consolidation efforts and putting the objective of reducing the public debt at risk. The Government has therefore revised the revenue and expenditure targets for the year and introduced new measures to achieve the new targets.

On the revenue side, the measures include the following:

- Conversion of the 2.5% National Health Insurance VAT to a straight levy of 2.5%;
- Conversion of the 2.5% GETFund VAT to a straight levy of 2.5%;
- Imposition of a luxury vehicle tax on vehicles with capacity of 3.0 liters and above;
- Reviewing the personal income tax to include an additional band of GH¢10,000 and above per month at a rate of 35%;
- Intensifying tax compliance measures; and
- Plugging revenue leakages.

The proposed measures are expected to lead to a revised total revenue of GH¢50,682.2 million (21.0% of GDP), compared with the original budget amount of GH¢51,039.1 million, implying a shortfall of GH¢352.9 million. Domestic revenue will reduce by GH¢527.2 million but this will be partly compensated for by an increase of GH¢174 million from grants (see Table 2).

Table 2. Revised Fiscal Framework for 2018

	Original Targets GH¢' m	% of GDP	Revised Targets GH¢' m	% of GDP	Variance GH¢' m	%
Total Revenue and Grants	51,039.1	21.1	50,686.2	21.0	(352.9)	(0.7)
Domestic Revenue	50,452.3	20.9	49,925.1	20.6	(527.2)	(1.0)
Tax Revenue	39,881.6	16.5	40,216.3	16.6	334.7	0.8
Non-Tax Revenue	8,047.2	3.3	7,444.9	3.1	(602.3)	(7.5)
Grants	586.8	0.2	761.1	0.3	174.3	29.7
Total Expenditure	61,151.8	25.3	60,798.9	25.2	(352.9)	(0.6)
Compensation of Employees	19,595.1	8.1	19,729.0	8.2	133.9	0.7
Interest Payments	14,909.8	6.2	15,091.6	6.2	181.8	1.2
Goods and Services	3,532.5	1.5	3,682.3	1.5	134.1	3.8
Transfers to Other Gov. Units	12,046.0	5.0	12,197.6	5.0	151.6	1.3
Capital Expenditure	6,896.3	2.9	6,393.3	2.6	(503.0)	(7.3)
Domestic-Financed	3,339.1	1.4	2,674.9	1.1	(664.2)	(19.9)
Foreign-Financed	3,557.2	1.5	3,718.4	1.6	161.2	4.5
Arrears	858.5	0.4	858.5	0.4	-	-
Overall Fiscal Deficit	10,971.1	4.5	10.971.1	4.5	-	-
Primary Balance	3,938.7	1.6	4,109.2	1.7	170.5	4.3

Source: Government of Ghana (July 2018)

Expenditure (including clearance of arrears), will also drop by GH¢352.9 million to GH¢60,798.9 million (25.5% of GDP), compared with the original budget of GH¢61,151.8 million. Domestic- financed capital expenditure will be contained by GH¢664.2 million (19.9%), to be partly offset by an increase in foreign-financed capital expenditure of GH ¢161.2 million. Compensation of employees, interest payment, spending on goods and services and transfers to other government units will all see increases in their revised targets. Like revenue, the revised expenditure also implies a shortfall of exactly GH¢352.9 million. By this, the fiscal deficit would be restored to its original target of GH¢10,971.0 million, or 4.5% of GDP (Table 2).

4.0 Observations and Comments

4.1. Macroeconomic Direction & Policies.

The rebound in real GDP growth from 2017 is being driven by the oil sector, which benefitted from increased investment in the period leading to 2017. Also, the oil sector is not only capital intensive, thus employing few Ghanaians, but the benefit from the sector accrues mostly to the foreign oil producing companies operating in the sector. Non-oil real GDP growth picked up but very slowly, from 5% in December 2017 to 5.4% in March 2018, and 4% in March 2017. The sluggish growth of the non-oil real GDP in the last three years was due to the dampening effect of the continued fiscal consolidation. According to the Government, non-oil economic growth is expected to benefit from improved access to finance, as lending rates decline on the back of continued reductions in inflation and balance sheet repairs in the banking system. Unfortunately, credit growth has remained subdued since December 2017, partly reflecting the increase of banks non-performing loans. Credit to the private sector declined sharply from 12.7% at end-2017 to 2.4% at end March 2018 and only rose by 5.7% in June 2018. This trend, however, fell short of the 15.1% recorded a year earlier. To stimulate strong non-oil GDP growth would require strong and sustained increases in capital expenditure, particularly domestic-financed capital expenditure.

While the government's new policy initiatives to promote growth and jobs, including One- District-One-Factory, One-Village-One-Dam and Planting for Food and Jobs, may be well- intentioned, they have not proceeded as expected and their potential effectiveness and impact remain uncertain. Boosting growth of the non-oil sector generally requires strong government support for businesses, including addressing the persistently large infrastructure deficit, reducing the level and multiplicity of corporate taxes, reducing the cost of credit, ensuring macroeconomic stability and ensuring adequate and stable supply of power.

Potential threats to the inflation outlook include the exchange rate, which has come under severe pressure in the second quarter of the year, and oil prices, which also rose significantly early in the year on the back of geopolitical factors, but has recently slowed down. Despite the decline since September 2016, Ghana's inflation over the last three years averaged 15.5%, significantly higher than the average of 7.2% in a sample of 11 sub-Saharan African (SSA) countries and 3.5% in selected 14 developing and emerging market countries with an inflation targeting framework. Ghana's medium-term inflation target and tolerance bands are also higher than in other inflation targeting countries, including SSA. At 8±2 percent band, Ghana's current target is the highest in the world. In developing and emerging countries, the average inflation target is 4% with average bands of 1.2%. Furthermore, inflation targeting countries in SSA have much lower targets. For example, Uganda has a target of 5%, while South Africa enacted bands of 3-6% (IMF, April 2018).

The high inflation in Ghana in the last couple of years has been driven mainly by the impact of foreign exchange pass through and import prices. According to the Bank of Ghana (July 2018), the upward movement in the inflation rate in May and June 2018 was due mainly to the recent increases in administered prices of petroleum and transport fares. Although, the second round effects from the relative price changes are not significant enough to alter the inflation trajectory over the medium term, there is the need for continued fiscal consolidation together with tight monetary policy to keep inflation within the target band of 8±2%, which is considered to be the highest in the world. Unfortunately, because the exchange rate appears to have become a de facto target in addition to the primary objective of price stability, the conduct of monetary policy has become more challenging. This dilemma seems to have led to a monetary policy stance that appears to be much tighter than desirable and which, in turn, has contributed to high lending rates of banks and consequent retardation in economic activity and (non-oil) growth.

Pressure has also been mounting on the domestic currency market, driven by developments in both the international and local markets. Crude oil prices on the international market increased by 18.2% on year-to-year basis to an average of US$75.9 per barrel in June 2018 due to constraints amidst geopolitical tensions. This, together with the normalization of US monetary policy and the resultant strengthening of the US dollar and rising US yield rates, and the increased domestic demand for foreign exchange exerted pressure on the domestic currency market. The effect has shown in early redemptions of coupons by investors holding Ghana's bonds and money market instruments. Consequently, the cedi, which had performed quite well against the major international currencies over the first four months of 2018, depreciated in May and June.

The lesson from the developments in the exchange market is that Ghana has to continue to build strong buffers so that the cedi can better withstand these potential shocks. The key buffers in this regard are sustained fiscal discipline and a strong cushion of reserves built on the back of a transformed and vibrant economy capable of generating enough foreign exchange on a sustainable basis. Without these fundamentals in place, the cedi will follow a persistent declining path with only brief intermittent periods of stability.

4.2. Fiscal Policy and the Adjustment to the Fiscal Framework.

The Institute for Fiscal Studies (IFS) wishes to commend the government for its commitment to operate within its set deficit target. Given the prevailing fiscal and macroeconomic conditions in the country, fiscal overruns could have a devastating effect on the macro economy. Strong domestic revenue mobilization is thus required for creating fiscal space for financing development programs and projects and protecting social programs, while maintaining macroeconomic stability. Unfortunately, over the years revenue targets continue to be missed and this is becoming a predictable phenomenon of the fiscus, undermining budget credibility and effective fiscal and macroeconomic management. Government's position appears to be that, if revenue underperforms, primary expenditures will be contained to match the lower revenues as happened in 2017, in order to achieve the fiscal deficit target of 4.5% of GDP. This position of the Government has serious implications for economic growth as the burden of the spending containment is always carried by domestic-financed capital expenditure which already has been reduced by a whopping GH¢664.2 million in the Mid-Year Budget Review to compensate for the projected drop in revenue and also support other expenditures.

The basis for the Government projecting end-year total revenue of GH¢49,610.4 million and total expenditure of GH¢61,010.3 million if no remedial actions are taken in the second half of the 2018 is also not known. While too much detail may not be necessary in the budget review highlights, it would be helpful to understand what informed these projections. This is because, the projections, based on unchanged policies, form the basis for the new measures proposed in the Mid-Year Budget to reverse the poor fiscal performance recorded during January-May 2018. One would better appreciate the proposed policy adjustments if what informed the revised annual fiscal projections were known. Without adequate information, one can only say that the annual projections for revenue and expenditure based on unchanged policy look a bit strange. For instance, the projected annual revenue shortfall of GH¢1,428.7 million under the "do nothing" scenario is the same as the January-May revenue shortfall. This implies that even with unchanged policies, the revenue target for June-December would be exactly met. In other words, no further shortfall in revenue would occur in the next seven months. This is clearly unrealistic, given past revenue record. Meanwhile, with expenditure shortfall for January-May already at GH¢1,550.0 million, the projected annual shortfall of GH¢558.7 million based on unchanged policy implies that the expenditure planned for the rest of the year would increase by GH¢991.3 million (i.e. GH¢1,550.0 million less GH¢558.7 million). This also appears unrealistically high.

The reasons advanced for the revenue shortfall by the Government raise a number of questions. First, the underperformance of revenue is not a surprising development as it has persisted since the inception of the 2017 budget, due to a number of factors. As noted earlier, Government abolished a wide range of taxes in 2017, describing them as nuisance taxes, ostensibly in fulfilment of its campaign promises. This policy created a hole in revenue that has not been filled to date. The view that the revenue loss from the taxes abolished would be partly recouped by reviewing the spate of import duty exemptions did not materialize. Meanwhile, the government's declared policy doctrine of shifting from taxation to production, ostensibly geared to reaping the potential benefits of private sector-led growth, is yet to bear fruit, as non-oil growth has virtually stagnated. Against all these odds, revenue projections have been overly ambitious, a fact that IFS has repeatedly drawn to the attention of the Government. Second, since the Minister of Finance identified key sources of revenue shortfalls during January-May, one would have expected that more attention would be focused on dealing with them. Instead, the attention has shifted to introducing a new set of tax measures, whose potential impact is difficult to ascertain. Moreover, the move is quite at variance with the Government's own policy philosophy to shift from taxation to production which informed the decision to abolish wide- ranging taxes in its first budget of 2017. In this regard, it appears that the Government has done a 360o turnaround in pursuing a key tenet of its policies enshrined in the NPP Manifesto. The apparent revenue quagmire deserves more far-reaching measures to address.

The low revenue from import VAT mobilized during January-May period was presumably the result of lower import volumes. But one would also want to know the impact of the "paperless" initiative at the ports, which, if working effectively, should somewhat have offset the effect of the low CIF values. On re-exports of ware-housed products, it would be helpful to know if this activity is legal or not and, if it is not, what is being done to stem it? Again, what accounts for the lower VAT/NHIL receipts from the telecommunication companies? Could it be the result of lower volume of transactions or the result of tax evasion? Regarding delays in tax stamp implementation, it is curious why the intake was projected at the level that it was when the timetable for implementation of the project was not certain. Against the government's early assurances to review import duties and tax exemptions to offset the wide-ranging tax abolitions and incentives introduced in the 2017 budget, it is curious that the government admits in the mid-year review that tax exemptions are still pervasive.

The conversion of the NHIL VAT and GET-Fund VAT of 2.5% each into straight levies of equivalent magnitudes may increase the overall tax intake for the government. This is because the new straight levies will not entail the usual refunds applicable to VAT and will fully accrue to government.

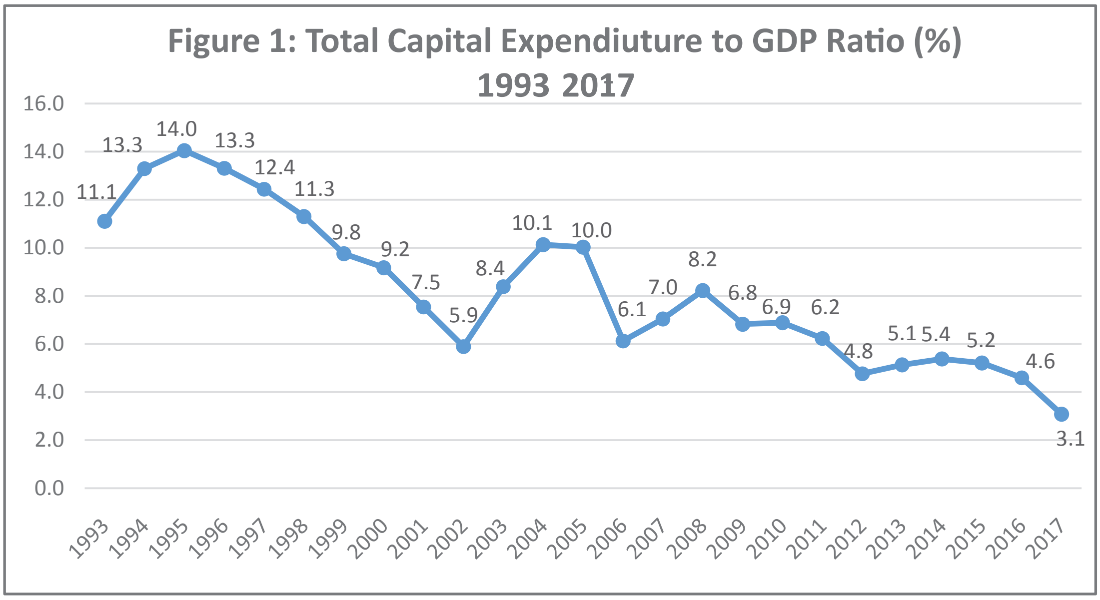
The new policy could also lead to higher prices if wholesalers and retailers wrongfully price in the new straight levies. Implementation of the policy would have to be closely monitored to maximise the tax intake while minimizing any potentially-undesirable effects. Imposition of a tax on luxury vehicles with capacity of 3.0 litres and above appears ill- advised. This is because, vehicles in that category already attract proportionately higher import duties. So why place further punitive tax on their use in the country? It is important to note that excessive taxation may rather encourage evasion and corruption rather than appreciably increasing the tax intake and reducing avoidance to the extent possible.

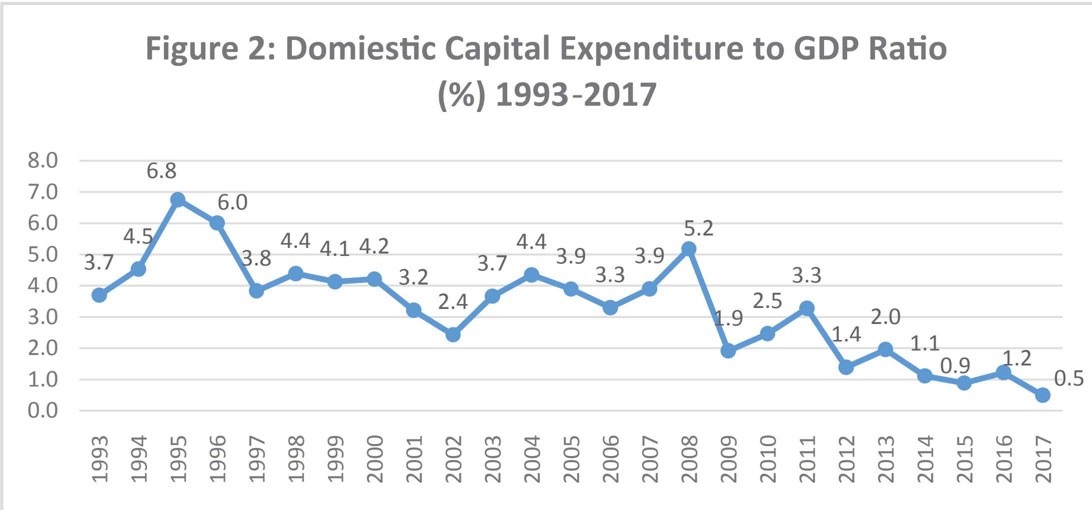
The decision to increase tax rates for incomes above a new threshold of GH¢10,000 from 25% to 35% also appears to be ill-placed and ill-timed. The fact is that, the Ghanaian income tax payer is already overburdened and should not be saddled with additional taxes. The policy also has the potential to add to employer costs as affected employees are likely to clamour for compensatory salary adjustments, which will be difficult to resist. The increased costs are then bound to be passed on as higher prices of goods and services. The more prudent thing to do is to pursue the widening of the tax net more aggressively, including through the ongoing formalisation initiatives. Further, reinforcing compliance and plugging tax leakages through the spate of illicit financial flows, including trade mis-invoicing and transfer pricing, will be effective in raking in significant amounts of revenue.

It would appear from the mid-year review statement that the government is less enthusiastic about reducing import exemptions (tax giveaways) in 2018 than it was in 2017. Although it is well-known that import exemptions in Ghana normally go to influential individuals, a significant decline in the amount of imports taxes given away as exemptions would bear testimony, practically, to the government's proclaimed willingness to close revenue loopholes and ensure accelerated revenue growth for national development, instead of over-taxing the same group of people that have long shouldered the tax-paying responsibility, as proposed in the 2018 Mid- Year Budget.

The large drop in capital expenditure during the review period is also a source of concern. As IFS has repeatedly pointed out, capital expenditure has continued to be sacrificed for recurrent spending, a situation which is detrimental to the growth of the economy. The sluggishness in non-oil growth is due in part to inadequate public investment spending. Worryingly, spending on wages salaries, goods and services recorded significant overruns. The implementation of the Single Spine Pay Structure since 2010, coupled with a growing public sector and weaknesses in payroll management have taken the wage bill to levels, which together with other statutory spending, have left virtually no fiscal space to meet critical development and social spending. Indeed, the wage bill this year is projected to be 7.1% of GDP (compared with 7.0% in 2017) and to consume 42.4% of tax revenue (slightly down from the 44.8% in 2017).

IFS wishes to caution again that the much needed capital expenditure is bearing too much brunt of the government's fiscal consolidation efforts, given the continuous underperformance of revenues. In fact, in 2017, the pressure on capital expenditure reached alarming proportions. Apart from 2012 when the nominal value of total capital expenditure went down by GH¢140 million, 2017 was the first year since 1993 that the nominal value of total capital expenditure went down, dropping by a whopping GH¢1.4 billion to GH¢6.3 billion, from GH¢7.7 billion in 2016. Significantly, capital expenditure has been trimmed from 2.9% of GDP to 2.6% of GDP, the lowest in probably a decade, while recurrent expenditure has been maintained at 19.1% of GDP. This means that the entire adjustment proposed on the expenditure side is being borne exclusively by capital expenditure. As Figure 1 shows, total capital expenditure as a ratio of GDP reached the lowest value of 3.1% in 2017 since 1993. And as Figure 2 demonstrates, domestically financed capital expenditure also reached its lowest level of 0.5% in 2017.





We refer above to a disturbing pattern in recent budgets whereby capital expenditure has been sacrificed for recurrent expenditure to the detriment of economic growth. And when we analyze further the components of recurrent expenditure, we find that wages and salaries increase from 6.9% of GDP to 7.1% of GDP and interest payment kept at 6.2% of GDP. It is unfortunate to have a situation where the wage bill and interest payment command as much as 7.1% and 6.2% of GDP, respectively, while capital expenditure commands a paltry 2.6% of GDP.

It is noted that the proposed adjustment on the expenditure side is relatively small and the brunt of adjustment to restore parity to the fiscal deficit is to be borne almost exclusively by the revenue side (an increase of GH¢1,075.8 million), with expenditure almost wholly protected (a decrease of GH¢205.8 million). It has to be emphasized that putting too much emphasis on revenue mobilization may be optimistic, and given government's stated commitment to achieve the fiscal deficit target, expenditure, especially the capital expenditure component, risks being squeezed further.

Again, while the difference in total expenditure for the original budget and revised budget (as explained above) is just GH¢352.9 million, there have been some remarkable and unwelcome movements in the components of expenditure. This situation is alarming and a rebalancing is required as a matter of priority. Reining in especially the wage bill, backed by public sector and payroll management reforms, is key to controlling expenditure so as to create the needed fiscal space to fund development and social spending without compromising the fiscal consolidation and debt sustainability goals. This, however, will require serious public sector and payroll management reforms. It is in this light that the IFS supports the Government's plan to outsource the payroll management.

As the IFS has pointed out in numerous occasions, the pressure on capital expenditure is the result of the current high degree of rigidity in the Ghanaian budget. It was for this reason that the IFS, at its Pre-Budget Forum in February 2017, advised Government on the need to cap earmarked expenditures so that the amounts above the cap would be sent back to the central government to ease the degree of rigidity, which the Government commendably accepted. Unfortunately, the intended fiscal flexibility has not been achieved since the cap was placed, due to the numerous new spending initiatives the Government has introduced, which have gobbled all the earmarked revenues above the cap. It is for this reason that capital expenditure that is needed to help close the huge infrastructure deficit in the country and thus open up the country's productive base, is suffering from such huge cuts. It is therefore worrying to see that Government has once again revised capital expenditure downwards by GH¢503 million in the 2018 Mid-Year Budget Statement.

The IFS fully supports the view expressed by the IMF that fiscal structural reforms should seek to increase transparency and accountability in the public sector to underpin fiscal discipline. To this end, the PFM regulations recently submitted to Parliament which seek to strengthen budget formulation and execution is laudable; steps to complete the Treasury Single Account should continue vigorously; and stronger oversight of the management of public revenue at any level of government should be pursued. The rollout of Human Resources Management Information System (HRMIS) to all MDAs is also a good project and needs to be implemented to its logical conclusion. This, together with the GIFMIS, will help clean the payroll system of ghost names, which the successive governments have failed to achieve in all these years. Greater oversight and accountability following the Auditor General's report on unpaid claims should also help reduce waste and corruption in the public sector, provided corrective actions are decisively put in place. Rationalization of public sector wages and salaries and planned control over the wage bill is paramount to reducing spending rigidities. The same can also be said about the plethora of statutory (earmarked) funds that have been created in the country.

4.3. Macroeconomic Direction & Policies.

First, the mid-year review statement re-emphasized the huge infrastructure deficit facing the country, which is estimated to be at least US$30 billion, and is mainly caused by inadequacy of financial resources to undertake the requisite investment. To bridge this gap, a barter agreement, which aims to open a new financing model for the country in undertaking future projects has been reached between the Government and Sinohydro Group of China to provide US$2.0 billion for infrastructure development, including roads, bridges, interchanges, hospitals, housing, rural electrification, in exchange for Ghana's refined bauxite. To this end, a bauxite refinery is to be established within the next three years in collaboration with selected private partners, including at least 30% local participation.

It is important to recall, however, that Ghana already has an infrastructure financing mechanism in place. The previous Government established the Ghana Infrastructure Investment Fund (GIIF) in 2014, following the passing of the GIIF Act, Act 877 of 2014 with a seed capital of US$250 million. The mandate of the GIIF is to provide financial resources to manage, coordinate and invest in a diversified portfolio of infrastructure projects in the country for national development. At a Post-Budget Breakfast Forum organized by PriceWaterhouse Coopers on November 22 2017, the Minister of Finance said that the Government is considering amendments to the GIIF law to increase the Fund to about US$2.0 billion to be a key player in the country's infrastructure drive. It is therefore unclear why the GIIF was set aside in the infrastructure financing arrangement with Sinohydro. Several questions remain unanswered. For example, what will be the implications if the Government is unable to fulfil its part of the deal, involving the supply of refined bauxite to Sinohydro? How will this barter arrangement fit in the country's fiscal management, given that the Government does not intend to add US$2.0 billion secured under this arrangement to the country's debt stock? Where does this arrangement fit in the programs of Road Fund and GETFund, the statutory funds set up to finance roads and schools infrastructure, respectively, and which are currently limiting the fiscal space for government discretionary spending?

Large scale infrastructure projects of the type envisaged under the Infrastructure for Refined Bauxite Arrangement can be very beneficial to the country as well as the Sinohydro Group who will undertake the construction and financing of the projects. However, the projects profitability and their benefits to the country are subject to numerous risks, including technological, managerial, financial, environmental, etc. risks. The efficient management of these risks is thus very critical to the success of the projects. Extreme care should therefore be taken when arrangements of this nature that have serious financial implications and risks for the country are negotiated. IFS is therefore of the view that, although the attempt to secure US$2.0 billion to support infrastructure development is laudable, for the purposes of effective management of the risks associated with the projects, the arrangement should be brought under the umbrella of the GIIF which has been set up to develop and finance such projects.

Second, it is important to mention that, although oil output is increasing, due attention must be given to cocoa and gold, which have remained the traditional backbone of the country's exports. It is equally important that Ghana moves away from exporting these commodities in their raw forms so as to reduce the economy's vulnerability to external shocks. Adding value to these products in the context of transforming and diversifying the economy is an important outstanding agenda that requires concrete steps to fulfil. Government's policy initiative to facilitate the building of one factory in every district can help this transformation process if it is carefully defined and designed, learning from the country's experiences with industrialization, particularly in relation to types and sizes of industries, ownership and management structure, and supply chain to ensure stable supply of requisite raw material inputs.

Third, the government embarked on the implementation of Free Public Senior High School (SHS) program in the 2017/18 academic year as one of its major social protection programs. This led to an increase in enrollment of students from the Junior High School (JHS) to SHS from an average of 72% in the last four years to 94% in 2017, indicating an increase of 90,000 more senior high school students. In September this year, it is expected that 180,000 more students will be enrolled, and additional 8000 teachers will also be engaged to support the system. Government policy towards this program in 2018 is guided by the Global Education 2030 Agenda/Targets, defined by the Sustainable Development Goal 4: Ensure Inclusive and Equitable Quality Education for all and promote Lifelong Learning. According to the government, full funding for the free SHS is provided for in the 2018 Budget.

As it is with any new educational policy, the free SHS initiative has come with its own challenges, such as inadequate infrastructure, including classrooms, dormitories and also teaching and learning materials. Given the importance of the policy and the challenges that have confronted it since its implementation in September 2017, the IFS is of the view that a wider public consultation to discuss all aspects of the policy, including the proposed Double- Track System, to ensure national inclusiveness should have been undertaken. The IFS therefore fully supports the view expressed by many, including the Ghana National Education Campaign Coalition, that a policy that affects millions of citizens requires broad-based consultations. Merely informing civil society through the media is not consultation. Rather, the discussions should be done country-wide with the view to engaging key stakeholders and mobilizing their ideas and support to ensure inclusiveness and sustainable implementation of the policy.

5.0 Conclusion

Ghana cannot have a lasting fiscal adjustment without increasing domestic revenue mobilization and rationalizing expenditure. Domestic tax revenue has stalled in the last couple of years despite the introduction of new taxes and large increases in some taxes. The IFS wishes to re- iterate the recommendations it made in its pre-2018 Budget Forum that the Government should work hard to widen the tax net to include the untaxed and the minimally-taxed. To this end, a critical look at the tax exemptions and tax holidays, including those granted by the Ghana Investment Promotion Council without consultation with the Minister of Finance, needs to be taken to ensure that those exemptions and holidays do not undermine the government revenue mobilization agenda. A widening of the tax net to include the Free Trade Zones, mining, oil and gas sectors, and the informal sector would be extremely helpful in strengthening domestic revenue mobilization.

IFS also recommends that the proposed increase in taxes should be reviewed as it is not only unfair, but it has the potential to discourage hard work and undermine economic growth. This, new tax measures are indeed at odds with the Government's development philosophy of "moving from taxation to production". In addition to ensuring fiscal consolidation as a route to achieving macroeconomic stability and growth, the government should undertake a comprehensive rationalization and reprioritization of expenditure to create space for priority spending. Government should ensure that capital expenditure is significantly and consistently boosted to help stimulate non-oil real GDP growth and generate employment to minimize the high unemployment rate, and also increase the tax base as well.

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