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The 2018 Fiscal Policy Objectives and Targets: What has changed?

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1.0 Background

Ghana has been facing fiscal difficulties since 2012 and the effects were at the forefront of the fiscal challenges that confronted the NPP government that came into office in 2017. For most of the past six years, large persistent fiscal deficits and a rising debt burden have posed an increasingly serious policy challenge for the country. The implementation of the single spine salary structure for the public sector in 2010, coupled with a sharp rise in energy-subsidy costs and fiscal transfers, rapidly increased public spending. Consequently, the fiscal deficit rose from 4% of GDP in 2011 to 11.6% in 2012, coupled with a rapid accumulation of government payment arrears. The emergence of a large fiscal deficit and external imbalances led to a slowdown in growth, putting the country's medium-term prospects at risk. Government's efforts to achieve fiscal consolidation since mid-2013 were undermined by policy slippages, external shocks and rising interest cost. As a result, the fiscal deficit remained far elevated and above its target levels, reaching 10.7% of GDP in 2013 and 10.1% in 2014 (World Bank, 2017).

In April 2015, the government requested a three-year arrangement with the IMF under the extended credit facility in an amount of SDR 664.2 million (US$918 million) in support of its medium-term economic reform program. The program, anchored on the second Ghana Shared Growth and Development Agenda (GSGDA II), aimed at a sizeable and frontloaded fiscal adjustment to restore debt sustainability, rebuild external buffers, and eliminate fiscal dominance of monetary policy, while safeguarding financial sector stability.

Despite the existence of the IMF-support program, fiscal consolidation was reversed in 2016. The overall fiscal targets were missed by large margins, with the fiscal deficit (on cash basis) reaching 9.3% of GDP compared with 7% of GDP in 2015 and the target of 5.2%, a negative primary balance of 2.4% of GDP and a debt/GDP ratio of 73.4%. This slippage was due largely to the failure to adjust overall expenditure in the face of a significant revenue shortfall. In addition to a decline in oil revenues, tax and non-tax revenues weakened across the board, particularly in the second half of the year. Tax compliance and enforcement were weak, and some programmed non-tax revenue proceeds from the sale of goods and services and dividends were not realized. While expenditure remained close to the Fund program target, spending pressures ahead of the general elections led to overspending on goods and services and foreign-financed capital expenditure. (IMF, 2017)

The NPP Government which came into office in January 2017 inherited a difficult economic situation, resulting from weak economic management, compounded by challenges with domestic revenue mobilization and several policy reversals, including unconstrained expenditures which ended 2016 with a large fiscal deficit and rising public debt stock.

The first budget of the new government presented in March 2017 aimed at restoring fiscal discipline and taking steps to mobilize revenue and tackle budget rigidities. Although a number of "nuisance" taxes were abolished as part of the government's goal of moving economic management from taxation to production, measures to broaden the tax base, improve compliance and plug revenue leakages were introduced. Domestic revenue mobilization was to be revamped by strengthening tax administration and compliance measures. The new government also moved to address the structural rigidities in the budget by enacting into law the capping and realignment of earmarked funds to 25% of tax revenue. The Act also allows for a larger share of internally generated funds of agencies to be channeled through the central government budget. A provision to raise revenue equal to 1.2% of GDP from the sale of thermal power plants and shares in publicly listed companies was also announced in the 2017 budget.

Expenditures were to be controlled in order to meet the deficit target of 6.3% of GDP set for the year. As contained in the 2017 mid-year budget review, the government adjusted downwards expenditures on goods and services and capital outlays by 0.8% of GDP. The government policy was that, if revenues underperformed, it would make adjustments in expenditure in order to meet the fiscal deficit target, and these adjustments could take the form of curtailment of discretionary spending on goods and services and capital. The government also decided to refrain from accumulating new arrears in 2017 and it promised to repay all outstanding arrears by end-2019 following the outcome of an audit of outstanding commitments generated as at end-2016. Meanwhile, a provision was made to clear arrears worth 1.8% of GDP in 2017 to eliminate all arrears recognized under the Fund-program, including over GH¢1.0 billion of new arrears accumulated in 2016.

Although the country's fiscal performance somewhat improved in 2017, with the fiscal deficit dropping to 5.9% of GDP, the serious fiscal slippages in 2016 made it impossible for the new government to achieve the program objectives by year-end 2017. The fiscal turnaround was achieved through expenditure cuts, amounting to 2.5% of GDP, which were imposed primarily on goods and services, clearance of arrears, and most significantly on domestic-financed capital expenditure. Total revenue (including grants) was short of the target by GH¢1.6 billion (1.9% of GDP), but the primary balance improved from a deficit in 2016 to a surplus of 0.8% of GDP in 2017. The debt/GDP ratio was also brought down to 69.1 % in December 2017, from 73.4% in 2016, reflecting a slowdown in the rate of external debt accumulation and higher GDP growth.

2.0 Fiscal Policy Objectives and Targets in 2018

Fiscal policy in 2018 is aimed at further consolidation to reduce the public debt burden and sustain the macroeconomic gains realized in 2017. To this end, the fiscal deficit is targeted to drop to 4.5% of GDP from 5.9% of GDP recorded in 2017, with a greater reliance on revenue growth than expenditure tightening to achieve the target. Total revenue and grants are targeted to increase to 21.1% of GDP (revised to 21% of GDP in the mid-year budget), while expenditure is set at 25.6% of GDP (revised to 25.5% of GDP in the mid-year budget). Although the size of the implied fiscal adjustment of 1.4 percentage points of GDP is smaller than what was achieved in 2017—when the deficit was reduced by 2.4 percentage points of GDP—the deficit target in 2018 is low in a historical context. If the targeted deficit of 4.5% is achieved, it would be the lowest since 2011 when a deficit of 4% of GDP was recorded. To make the 2018 fiscal policy maintain a declining debt path, the budget has been designed to produce a primary surplus of 1.7% of GDP. Based on this primary surplus and other macroeconomic assumptions for the year, the public debt burden is projected to fall from 69.1% of GDP in 2017 to 67.8% of GDP this year, having initially declined from 73.4% of GDP in 2016.

The outcome of the 2018 budget during the first seven months of the year was not encouraging. The fiscal deficit (cash basis) stood at 3.8% of GDP against a target of 3.3%. This outcome was mainly the cause of a significant shortfall in domestic revenue amounting to GH¢2.5 billion (1% of GDP), which is reminiscent of the fiscal policy performance in 2017 and the recent past. As a result of the revenue shortfall, expenditure was cut by GH¢1.6 billion (0.6% of GDP), with the axe falling mainly on interest payments, which was cut by GH¢565.2 million (6.3%) and grants to other government units also cut by GH¢324.1 million (5%). Capital expenditure suffered the largest cut of GH¢1.0 billion (28.1%), with almost all of the cut falling on domestic-financed capital expenditure. However, expenditure on goods and services during the period exceeded the target by GH¢752.4 million (36.2%). Even though interest payments and transfers to other government units were cut, spending on the two items together with wages and salaries amounted to GH¢24.6 billion during the period, meaning that the total domestic revenue of GH¢24.3 billion mobilized during the period was absorbed by the three expenditure items. Although, the cut in interest payments could not help to achieve the targeted fiscal deficit, it may also lead to the accumulation of new statutory payment arrears as revenue underperformance remained a risk to the budget.

The weak fiscal consolidation efforts in 2018 have also contributed to the rising public debt. The public debt stock which stood at GH¢142.3 billion in December 2017 (excluding the GH¢4.7 billion ESLA Plc. bond issued in October 2017) had by July 2018 risen to GH¢159.4 billion. This indicates that the country's debt stock increased by GH¢17.1 billion during the first seven months of this year, and by GH¢36.8 billion in the less than two years of the NPP administration. As a percentage of the old GDP, the debt stock dropped from 69.1% in 2017 to 65.9% in July 2018.

The IMF has repeatedly warned about Ghana "facing a high risk of (external) debt distress" in its reviews of the country's ECF-supported program. While the debt stock may be used to indicate the degree of distress, it is actually the debt service cost that represents an immediate and worrying burden. Ghana currently spends over 40% of its tax revenue to service debt. In 2017 and the first seven months of this year, the government spent over 41% of tax revenue on interest payments. Interest payments together with other statutory obligations continue to place considerable strain on the budget, limiting the space for critical development and social outlays.

Ghana's revenue mobilization effort continues to fall short of its potential as well as that of many of its peers. Ghana's tax/GDP ratio of 16-17% has been estimated conservatively by the World Bank to be about 5% of GDP below its potential and compares unfavorably with the average of about 25% for low-middle-income countries. The country's low tax effort is caused by many factors, including the near-exclusion of the informal sector from the tax net, high level of tax exemptions, pervasive tax evasion, overly-generous tax incentives offered to the extractive and free-zones companies, under-taxation of properties, illicit financial flows and other tax fraud, and corruption. Although the new tax measures announced in the mid-year budget may help increase domestic revenue, the tax intake in the year will be affected by the decision to abolish several taxes and levies in 2017, in line with the government's stated policy of "shifting management from taxation to production."

3.0 What has changed?

The 2018 fiscal policy objectives and targets are not different from those of the past three years, as they all focus on fiscal consolidation to rein in the public debt to ensure fiscal sustainability and strengthen macroeconomic stability. First, due to the fiscal slippages in 2016 and the lag in policy implementation arising from the change of government, there was the need for more time for the new government to bring the IMF-support program back on track and achieve its objectives. For this reason, the NPP government requested the IMF to approve waivers for non-observance of the program targets for 2016. The government also undertook to complete the program through its budget cycle of

January-December 2018 and therefore requested for approval to modify the length of the arrangement by one-year and reschedule disbursement of the program support (IMF, 2017). Quite clearly, therefore, the policy objectives of the government in 2018 have to respond to the structural benchmarks of the Fund-support program agreed upon in April 2015.

The unfortunate aspect of Ghana's situation is that the objective of strengthening the fiscal position by mobilizing substantial additional domestic revenue and rationalizing expenditure to create space for policy maneuver has eluded the government in the past three years, and will do so this year. The achievement of the fiscal objectives depends largely on the strength of the revenue and expenditure policies underpinning them and how they are effectively implemented to attain the desired ends. For example, given that the planned fiscal adjustment in 2018 is predicated on revenue growth contributing more (around 60%) to the deficit reduction than expenditure reduction (around 40%), then reversing the pattern of weak revenue mobilization which has bedeviled fiscal policy effectiveness in recent years is vital. This is required to avoid the kind of adjustment that leaves large areas of the government budget, especially capital and social spending unfunded or severely retrenched due to the inability to mobilize the needed revenues.

Achieving the envisaged fiscal consolidation without resorting to sharp expenditure cuts which harm effective execution of government policies and programs would require a doubling up of the revenue mobilization effort. Although the new taxes which were announced in the 2018 mid-year budget may provide some relief, they will certainly not address the underlying weaknesses in tax and non-tax revenue policies and their administration, which are largely responsible for the poor revenue mobilization.

Over the years, overall budget management has been complicated by increasing off-budget activities through revenue earmarking, exacerbated by quasi-fiscal activities. To address this, the government passed the Earmarked Funds Capping and Realignment Act in 2017, which limits transfers to statutory funds to 25% of total tax revenues. Before the legislation was passed, pre-determined expenditure through earmarking accounted for about 30% of revenues and 20% of expenditure, limiting flexibility in the budget. The budget flexibility was further limited through quasi-fiscal operations of state-owned enterprises. Furthermore, budget execution remains unpredictable due to weaknesses in treasury management such as cash-flow forecasting and cash-investment procedures, which often results in delays in payments to service providers, making the budget outcomes to deviate from the targets and contributing to the accumulation of arrears.

Government has since 2016 committed itself to some key legislative actions to help cement the fiscal consolidation path and ensure long-term fiscal sustainability. The government took steps in 2016 to pass the Public Finance Management Act (PFMA) to entrench all the elements of a fiscal responsibility law. It also proposed for (i) the establishment of a Fiscal Council that would ensure credibility of the country's fiscal projections, setting up medium-term anchors to guide fiscal policy, and monitoring compliance with the fiscal policy rules; and (ii) a requirement for all government payments to have a corresponding purchase order in GIFMIS as an effective way of controlling expenditure was also made by the government. The government also embarked on a domestic debt re-profiling program, which aimed to extend the tenor of public debt by issuing longer-term bonds to replace short-term debt.

4.0 What is required to be done?

There is a need for far-reaching measures to significantly increase domestic revenue to help loosen the rigidity of the budget and create space for policy maneuver. IFS has written and spoken extensively on this issue, but it is important to repeat here some of our recommendations to turn the situation around in 2019 and the medium term. The recommendations are tailored to addressing the lapses in the tax policies and administration mentioned earlier. Roping most of the informal sector into the tax net is key to increasing the overall intake. Recent efforts to digitize various areas of economic activity, including the issuance of tax identification numbers, promise to increase tax revenue from the informal sector. The efforts should, therefore, be reinforced and fully followed through, backed by close monitoring to avert any abuses. There is also the need to completely overhaul the tax- exemptions regime, plug all loopholes, deal with vested interests, check abuse and reduce exemptions to the minimum. Tax rebates granted to the mining sector and free zones should be reviewed to maximize revenue and also bring them in line with modern trends and standards. Some of these tax rebates were granted decades ago and have become obsolete and are inimical to the country's interest.

There is also the need to undertake periodic revaluation of properties to ensure that the assessed property taxes are commensurate with the commercial values of the properties. District Assemblies which are responsible for collecting property taxes seem to lack the capacity and resources to undertake property revaluations and collect the due taxes. The District Assemblies should therefore be adequately resourced to enable them carry out their responsibilities fully.

Illicit financial flows through trade mis-invoicing and other malpractices are estimated to cost Ghana billions of dollars in revenue losses. According to DANIDA and World Bank studies, the revenue losses to Ghana through these shady deals result in annual losses of between US$2-5 billion. The recently introduced Cargo Tracking Note (CTN) is therefore an important step in checking trade mis-invoicing and should be rigorously enforced.

While making efforts to increase domestic revenue, it is equally important that the government spends whatever it collects prudently and efficiently to promote national development. Concerted efforts to reduce and rationalize expenditure are urgently required. IFS has again articulated extensively on expenditure rigidities—in the form of earmarked funds, wages and debt service—that virtually hold the budget hostage and leave little or no space to address critical development and social outlays. With the limited fiscal space, it is more important to contain consumption spending, including travel, entertainment, subsidies, free allowances, etc. Expenditure on what is obviously a bloated public sector needs to be curtailed through appropriate reforms, including possible down-sizing of the sector. In this regard, some of government's policy initiatives, such as nursing trainee allowances, teacher trainee allowances and some components of the free Senior High School policy, may have to be re-examined to reduce costs while exploring other non-government funding alternatives. A stark consequence of the large shortfalls in revenue has also been a severe depression of critical capital and social expenditure. In fact the capital budget has virtually been cut to the bone. The continuing squeezing of critical capital expenditure is a trend that is inimical to long-term growth and needs to be reversed. Serious expenditure rebalancing in favour of productive capital spending to enhance long-term growth and development is urgently required.

Ghana has a large deficit in infrastructure in the form of roads, railways, bridges, ports, harbours, housing, power distribution facilities, communications facilities, etc. The gap has arisen as a result of inadequate public investment over the years as the capital budget has been continually trimmed amid revenue shortfalls coupled with growing recurrent and statutory outlays. The need to scale up infrastructure development has become urgent, and finance remains a key binding constraint.

To fill the gap in the country's infrastructure financing, government has expressed its intention to enter into a bauxite-infrastructure exchange arrangement, involving some US$2 billion with the Sinohydro Group from China. There has been quite a debate about whether the exchange is a barter, as government claims, or a loan, as others maintain. But this debate aside, there are unanswered questions regarding the exact terms of the agreement, including Ghana's obligations and the consequences for possible breaches of the agreement.

There appears to be a real risk of what is initially intended to be a barter or loan agreement turning out to become an equity transaction with the Chinese eventually taking over the country's strategic and essential infrastructure as has happened in some African countries, including Zambia. This calls for a careful approach to the arrangement to ensure that all the loopholes are considered and appropriately plugged to minimize the potential adverse consequences while maximizing the benefits to the country.

Government has also proposed to issue a US$50 billion century bond to finance infrastructure development. Here also, there are questions regarding the financial terms, the timeframe for sourcing these funds, etc. Obviously, the bond is going to impose a huge financial burden on the country in terms of the long-term repayment cost as well as the short-term servicing cost. Also critical is the question of Ghana's capacity to absorb such a huge amount in an efficient manner. IFS has expressed widespread views on the century bond in a published paper, which can be accessed from the Institute's website.

At this juncture, attention has to be drawn to the availability of the Ghana Infrastructure Investment Fund (GIIF) with initial seed capital of US$250 million. One wonders why it does appear that the Fund is not playing its original role of serving as a source for funding a diversified portfolio of infrastructure projects to promote national development. Creating parallel systems, as it appears is being done currently, stands the risk of inefficiency and counter- productiveness.

5.0 Conclusion

Ghana's economic outlook faces a number of domestic and external risks. On the domestic front, substantial fiscal challenges, manifesting themselves through weak domestic revenue mobilization and difficulties in containing non-discretionary expenditures continue to undermine fiscal sustainability, macroeconomic stability and economic growth. To sustain the momentum of fiscal consolidation to maintain fiscal sustainability, strong domestic resource mobilization and comprehensive expenditure rationalization to help create space for policy maneuver, supported by growth-enhancing efforts are critically needed. Also, with Ghana already at a high risk of public debt distress, any further fiscal slippage could have a significant adverse impact on the debt dynamics with serious implications for investor confidence.

To improve domestic revenue mobilization, enhanced tax compliance and the broadening of the tax base are imperative. To improve compliance, the Ghana Revenue Authority (GRA) needs to rapidly advance action on the use of taxpayer information through integration of data and analytical reporting to enable tax officials to identify taxpayers (especially in the informal sector) not yet captured and obtain accurate information on the existing ones. The Integrated Data Warehouse and Business Intelligence System being implemented by the GRA will greatly help the authority in the areas of audits, enforcement, and tax policy formulation.

The IFS' recommendations in various publications on ways in which the government can boost domestic revenue mobilization remain relevant and should be seriously considered by the government. These recommendations include reviewing the fiscal regime for the mining sector to broaden the revenue base; reviewing tax exemptions with the view to abolishing those that have questionable economic benefits and limiting the revenue losses; enhancing state-owned enterprises' governance to increase profitability and dividend payments to the central government; adopting strategies to widen the income tax base; and revamping property and rent taxation.

Finally, it has to be stressed that enough domestic resources can be mobilized and used to develop the country and realize the government's vision of "Ghana beyond Aid" through a comprehensive revenue-enhancing strategy, involving changes in tax policies, tax systems, tax administration, tax compliance and enforcement mechanisms. This, however, has to be supported by a well-designed rationalization of expenditure to contribute to the creation of fiscal space for policy maneuver.

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