INSTITUTE FOR FISCAL STUDIES

FISCAL ALERT

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The Mid-Year Review of the 2017 Budget Statement and Economy Policy

1.0 Introduction

1. The Minister for Finance presented the 2017 Mid-Year Budget and Fiscal Policy Review to Parliament on 31st July, 2017. Prior to the review, IFS issued an assessment of the performance of the economy and the budget and made recommendations to address shortcomings that it had identified. During IFS' pre-Mid-Year Review assessment, most of the data available at the time was up to April. The Minister, however, provided updated data in his review in most cases up to June. The IFS has critically looked at the Mid-Year Review and presents its assessment in this paper.

2. The IFS wishes to state up front in this assessment as follows:

- The Mid-Year Review confirms IFS' observation that macroeconomic performance was mixed, with broad stability achieved in most key indicators whereas economic growth, especially of the non-oil sector, has been disappointing.
- The severe shortfall in revenue that occurred through April has been extended through June, forcing further drastic reduction in expenditure, including in critical areas, as Government has adhered to a strict deficit target. The fiscal retrenchment will have a continuing dampening effect on economic growth.
- In the second-half of the year, IFS reiterates its call for strong efforts to raise revenue so as to avoid further cuts in expenditure that would have disastrous effects on the economy.

2.0 Macroeconomic Performance

3. The Mid-Year Review confirmed the strong overall real GDP growth in quarter one driven by higher oil output, whereas non-oil GDP growth was severely depressed. The projected annual non-oil growth of 4.6% (same as for 2016), which the IFS has described as being disappointingly low, was maintained. As was also observed by IFS, the Mid-Year Review confirmed improvement in macroeconomic stability in the first half year, with most key indicators, including inflation, the exchange rate, interest rates, the external accounts and international reserves, moving in the right direction.

3.0 Budget Implementation and Fiscal Performance

4. IFS noted in its pre-Mid-Year Review assessment that fiscal performance was mixed, with a severe shortfall in revenue forcing a sharp reduction in expenditure as Government contained the deficit within the target. The updated data through June indicates a continuation of the shortfall in revenue and further expenditure cuts. The budget deficit was held at 2.7% of GDP compared with the target of 3.5% of GDP.

5. Revenue performance was disappointing. Total revenue (including grants) was short of the GH₵20.5 billion target by GH₵3.1 billion or 14.9%. As a percentage of GDP, the revenue collected was 8.6% against a target of 10.1% and also less than the outturn of 9.8% in the first half of 2016. The poor revenue performance is reflected in almost all the revenue lines. In the Mid-Year Review, the revenue target was revised downwards by GH₵1.9 billion to GH₵43.1 billion, which is 28.0% more than was collected in 2016. It is the IFS' view, however, that the revised target remains ambitious. The reason is that, in the first half of the year, revenue growth was just 6.5% year-on-year, and to achieve the new target would require revenue to increase by 48.3% year-on-year in the second half of 2017. While we recognize the potential for higher revenue performance in the second half of the year, a jump of 48.3% year-on-year seems unrealistic.

6. The weak revenue performance prompted a sharp reduction in expenditure of GH₵4.6 billion or 16.7%, more than the revenue shortfall. Total expenditure was reduced from the target of GH₵27.6 billion (13.6% of GDP) to GH₵23.0 billion (11.3% of GDP). The reduction in expenditure was spread across all the major components. For the year as a whole, the projected total expenditure has been reduced from GH₵58.1 billion to GH₵55.9 billion, representing a cut of GH₵2.2 billion or 3.8% and the axe fell mainly on goods and services (GH₵867 million); capital expenditure (GH₵683 million); and transfers, including statutory and earmarked funds (GH₵553 million).

7. The Minister stated that savings from interest cost of GH₵612 million was made in the first half of the year following the re-profiling of domestic debt. However, it is not clear how the GH₵612 million savings made compares with the total

interest cost for extending the maturities of the domestic debt to 7 and 15 years. We are informed that arrears clearance is to be expedited in the second half of the year and eliminated completely by end-2019. According to the Minister, the outcome of the arrears audit will be completed by October 2017. Meanwhile, the non-payment of arrears is having serious implications for private sector businesses and thus for growth and should therefore be addressed as a matter of urgency. That said, it is expected that the budgeted cuts in expenditure will not be circumvented by the MDAs to accumulate new arrears.

8. Updated figures show that the public debt increased by GH₵16.2 billion from GH₵122.3 billion at the end of December 2016 to reach GH₵138.5 billion at the end of June 2017. In terms of percentage of GDP, the Minister only reported the figure for end of March 2017 to be estimated at 70.9%. Further, he reported that the debt-to-GDP ratio is expected to be around 71% by the end of the year. However, the Minister's figure of 70.9% for March differs from the 62.5% published by Bank of Ghana. The difference appears to be the result of the use of different measures of GDP to divide the nominal debt. It is known that Bank of Ghana used the GDP projection for the year; however, the GDP figure used by the Minister is not certain. It is important to reconcile the figures so as to avoid confusing international investors and markets.

9. The Minister's Budget-Review statement could have provided more detail in some areas to help in making informed assessment, including relating to the following:

- Planned measures to ensure that the revised revenue target is met;
- Expenditure cuts in the first-half of the year, including relating to: expenditure per function (MDAs); how the distribution of the goods and services cut across MDAs; the specific statutory and earmarked funds that were cut and the amounts involved; the capital expenditure that is cut, such as sectors, projects (new or ongoing projects), infrastructure, etc., that suffered the brunt of the expenditure cut;
- In protecting spending on Government's flagship projects, amounts budgeted for each of the projects; the expenditures to date; and the measures put in place to ensure efficiency in spending on these projects; and
- On the energy sector debt, plans or measures to ensure financial viability of the energy sector beyond appointing Lead Managers to establish SPV to issue medium-to-long term domestic energy bond by securitizing the ESLA receivables.

4.0 Key Observations and Recommendations

10. The slow growth of the nonoil sector in the year is worrisome, especially as the sector has seen continuous decline in growth since 2013. There is urgent need for policy initiatives geared to revamping the non-oil sector, particularly agriculture and manufacturing, to ensure balanced growth of the economy. As suggested by IFS, Government should accelerate the various private sector-supporting policy initiatives. Government's commitment to strengthen collaboration with the private sector to address issues such as tax, energy, and cost of credit, which businesses have repeatedly cited as impediments to their progress, is a step in the right direction and should be followed through.

11. The fiscal developments in the first-half of the year did not come as a surprise to the IFS. This is because when the budget was tabled in Parliament in March, the IFS pointed out that the projected revenue target of about GH₵45.0 billion for the year, or 33.5% above 2016 receipts, was too optimistic and could not be achieved unless measures were introduced to grow the non-oil economy and enhance revenue administration. Given the disappointing performance in the first-half of the year, the revised annual projection, while slightly lower than the original projection, still looks optimistic, in IFS' view.

12. While the Minister's decision to align expenditure strictly with revenue may be prudent policy, with the axe falling, inevitably, on discretionary spending, the policy risks dampening economic activity, which in turn, will affect revenue collection.

13. Indeed, fiscal policy is currently facing a dilemma that has, in a large part, arisen from what the IFS has indicated time and again that Government has no fiscal space for discretionary spending due to the strong earmarking of revenue for statutory payments. This is why following IFS' suggestion to Government to review the statutory funds and determine their individual viability, we were happy to see a cap of 25% of tax revenue placed on payments to the funds while carrying out the review.

14. The IFS wishes to emphasize that the situation whereby a severe shortfall in government revenue has led to a drastic reduction in expenditure in critical areas in the bid to meet strict deficit targets is neither desirable nor optimal. If the situation is not properly addressed, the country faces a severe financial crunch which threatens general economic activity and growth. We urge Government to urgently embark on an aggressive revenue mobilization drive to significantly improve tax performance, including through the following measures:

- Improving the tax revenue performance of the key segments, i.e., large business taxpayers, high net-worth individuals, and the informal economy;
- Strengthening management and compliance risks;
- Revamping VAT management;
- Addressing the accumulation of tax debts and enhancing collection enforcement;

- Increasing the effectiveness of tax audit investigations;
- Further reducing exemptions; and
- Plugging leakages through under-invoicing of imported goods, revamping the bonded warehousing system, dealing with fraud involving collusion between tax payers and tax collection officials.

The above revenue-enhancement measures should be supported by improved efficiency of government spending and implementation of measures to support strong non-oil economic growth.

15. The banking sector is facing serious challenges, which, if not addressed, could threaten the stability of the sector, with potential adverse consequences for the economy as a whole. The high and rising NPLs, which the Minister has rightly acknowledged as threatening the banking sector, remains a source of concern. To help ameliorate the situation, IFS reiterates its call to Government to follow through with the plan to issue bonds to liquidate the energy sector legacy debt. The Institute also wishes to repeat its suggestion to Bank of Ghana to consider reducing the primary reserve requirement to ease the cost to banks.

16. Finally, the Minister indicated Government's intention to introduce a numerical fiscal rule in the form of a 3-5% limit on the deficit to guide implementation of fiscal policy. The IFS welcomes Government's decision to give priority attention to this issue and to place it in the public domain at this time. The IFS expects that wide consultations with key stakeholders will be undertaken to arrive at a national consensus to deal decisively with the problem of fiscal indiscipline and its macroeconomic consequences that have bedeviled Ghana for decades.

INSTITUTE FOR FISCAL STUDIES

Residential Address
No. 13, 2nd Close, Airport Residential Area, Accra, Ghana

Postal Address
P.O. Box CT 11260, Cantonment, Accra, Ghana

+233 302 786 991
info@ifsghana.org
www.ifsghana.org