Review of the 2020 Budget Statement and Economic Policy of the Government

By The Institute for Fiscal Studies

On 13th November 2019, Finance Minister Ken Ofori-Atta presented the budget statement and economic policy of the government for the 2020 financial year. The statement contained a review of the macroeconomic performance in the first three quarters of 2019 as well as projected fiscal outturns for the whole year. It also outlined the macroeconomic policy direction and targets for 2020 and the medium term.

The Institute for Fiscal Studies (IFS) sets out below its assessment of the statement together with recommendations to strengthen economic management and performance.

1. Assessment of 2019 Performance and Projections

1.1 Economic Growth

- At 6.2% and 5.2% respectively, both overall and non-oil economic growth rates were stronger in the first half of 2019 than for the same period of 2018, which registered overall growth of 5.4% and non-oil growth of 4.6%. An upsurge in services sector activities drove the performance, while growth rates subsided in agriculture and industry. Agricultural growth in particular slowed down sharply to 2.6% in the first half of 2019 from 4.7% in the same period of 2018. This presents major downside risks to the 6.4% annual growth rate projected for the sector in 2019 and the 7.0% growth rate projected for the whole economy this year.

1.2 Macroeconomic Stability

- The macroeconomy has been broadly stable in 2019, despite heightened exchange rate pressures during the year and marginal rises in treasury interest rates. During the first seven months of the year, the average rate of inflation stood at 9.3%, against 10.0% during the same period in 2018. New data published by the Ghana Statistical Service (GSS) since August 2019, after the rebasing of the Consumer Price Index (CPI) series, suggest that Ghana's inflation profile is now lower, with inflation measured at 7.7% in October. The performance of the exchange rate, on the other hand, has been poorer than in 2018. The rate of depreciation of the cedi in the first nine months was 9.3% compared with 7.6% in the same period of 2018. For treasury interest rates, fiscal expansion has halted their decline this year, with both the average 91-day and 182-day rates inching up by 1 percentage point to 14.7% and 15.2% respectively during the first three quarters of the year. Medium term rates have also increased by about 2 percentage points on average, but the average interbank lending rate and average lending rates to customers have fallen marginally by 1.6 percentage points and 0.2 percentage points to 15.4% and 27.7% respectively. To achieve significant declines in interest rates, the government should exercise fiscal restraint, underpinned by stronger tax and non-tax revenue collection and improved expenditure efficiency.

1.3 Fiscal Performance and Public Debt Developments

- The fiscal position is projected to marginally deteriorate past what the mid-year budget statement foresaw, with the budget deficit in 2019 expected to be 0.2 percentage points higher than the programmed ratio of 4.5% of GDP. A careful look at the 2019 projected outturn data reveals that Ghana's fiscal challenges seem to be compounding. The degree of rigidity in the budget has increased, with the three rigid expenditure items exceeding total revenue and grants by as high as 21.1%, the highest under the Fourth Republic. This trajectory is fiscally unsustainable as it is the main cause of the rapid debt build-ups.

- Once again, the total revenue and grants target is unable to be met. The projected outturn of GH₵54.6 billion is 7.4% below the mid-year revised projection and 1.2 percentage points lower in terms of GDP. While all the major components of revenue are expected to be lower than the mid-year budget forecasts, foreign grants and international trade taxes are among the worst performers, with projected shortfalls of 24.9% and 19.2% respectively. The weak international trade tax receipts is the result of the reduction in benchmark import values in April 2019, aimed at boosting the competitiveness of Ghana's ports. What the low receipts reveal is that, contrary to the government's prediction, import volumes have not expanded to compensate for the reduction in the benchmark values.

- To contain the deficit within the 5%-of-GDP statutory limit, all the major expenditure items have been cut. As has become the norm, central government capital spending will suffer the worst cut. Relative to the mid-year estimate, projected capital spending shows a reduction of 21.7%. In fact, the cutback to domestic-financed capital expenditure is as large as 38.7%. Such steep cuts to public investment spending undermine the long-term growth potential of the economy.

- Ghana's public debt stock continues to mount as it climbed to GH₵208.6 billion in September 2019 from GH₵173.1 billion at the end of 2018. Correspondingly, the debt-to-GDP ratio widened from 57.6% to 60.6%. Excluding the financial sector bailout bonds, the debt stock at end-September stood at GH₵197.9 billion, equivalent to 57.4% of GDP. With the more expansionary fiscal stance projected for 2019, the debt stock and ratio will experience further hikes in the rest of the year, calling for tougher measures in 2020 and beyond to address underlying budget rigidities that impede attempts to improve debt sustainability.

2. Assessment of 2020 and Medium-Term Budget Targets

2.1 Economic Growth

- The economy is forecast to expand at a respectable 6.8% rate in 2020, which is marginally lower than the 7.0% projected for 2019. Excluding the oil sector, growth is forecast to be 6.7% against a projected 5.9% for 2019. Over the medium term (2021-2023), however, both total and non-oil economic growth rates are predicted to slide downwards, with overall GDP growth decelerating to 4.6% in 2022 before rising to 6.5% in 2023 and non-oil growth declining to 5.5% in 2022-23. Given the plethora of agricultural and industrial modernization programs outlined in the budget, as well as the infrastructural initiatives and financial sector

reforms, the forecast slowdown over the medium term is baffling, especially as the budget is silent on what will drag down the rate of economic growth. To further reduce poverty and improve incomes substantially, growth rates higher than foreseen in the medium term are required. If the medium-term growth forecasts are to be believed, then the disconnect between them and the government's ambitious agenda warrants a critical examination to identify the causes and potential policy responses.

2.2 Fiscal Policy Targets

- The budget projects a stable fiscal position in 2020 relative to the projected outturn for 2019, with the deficit forecast to be 4.7% of GDP again. While the target is within the statutory deficit ceiling of 5% of GDP, it leaves very little scope for slippage if the ceiling is to be respected. Given election-year fiscal risks, as well as the mounting debt situation, a tighter deficit target would have been more appropriate.

- For the fourth straight year the government's revenue projections are overoptimistic, and it appears the lessons from the last few years have not been learnt. In 2019, the revenue target is projected to be missed by 1.2 percentage points, with estimated receipts of 15.8% of GDP—same as the actual outturn in 2018—against a revised budget target of 17.0% of GDP. Despite this, revenue is projected to rise to 16.9% of GDP in 2020, an increase of 1.1 percentage points. The revenue overprojection is further underscored by the fact that the projected nominal increase in revenue and grants of GH₵12.5 billion in 2020 is 68% higher than the average annual increase in revenue and grants of GH₵7.4 billion during the last three years. Moreover, the revenue forecast is predicated mostly on certain one-off but vague non-tax revenue items and repeated promises to pursue efficiency in revenue collection, which did not make a significant impact on revenue mobilization in the past.

- Like revenue, government expenditure is projected to increase by 1.1 percentage points in 2020, to 21.6% of GDP. All the main line items are forecast to increase, with capital outlays in particular growing by 53.5% in nominal terms. However, with revenue and grants overprojected, and since fiscal policy is now constrained by a deficit rule of 5% of GDP that the government has pledged to stick to, the spending plans may not materialize as expected, with capital spending especially at risk of being sacrificed, as the case has been since 2017.

3. Observations and Recommendations

- The government's revenue mobilization strategies, which include digitization to improve taxpayer identification as well as revenue administration reforms to enhance efficiency, seem inadequate to achieve a significant increase in domestic revenues in both the short and medium term. To this end, we propose the following additional measures to support revenue mobilization: (i) the passage of the Tax Exemptions Bill to address the excesses of the country's overgenerous exemptions regime; (ii) improving tax compliance by using taxpayer information (personal identification number), integration of data and analytical reporting; (iii) reviewing the natural resources fiscal regime to broaden the revenue base; and (iv) undertaking a comprehensive review of the tax system to identify the strong and weak

segments of the system, in terms of the design, bases, rates, revenue potential relative to actual receipts, and to pursue corrective measures to strengthen tax mobilization.

- The strong negative impact of the reduction in benchmark import values on international trade taxes and the recently aborted luxury vehicle levy expose weaknesses in revenue policy impact analysis by the government. We recommend that revenue policy decisions be informed by rigorous cost-benefit analyses to ensure better policymaking and achieve positive results.

- Because 2020 is an election year, the issue of fiscal discipline cannot be overemphasized. Election year fiscal overruns have become a characteristic feature of Ghana's public financial management culture, and it will be a feather in the cap of the government if it avoids a fiscal overrun in 2020. To accomplish this, we recommend, in addition to the revenue measures, cutbacks to consumption-based expenditures. This should include minimizing the size and avoiding the introduction of new initiatives while directing the savings into additional public investment and reductions in borrowing.

- The government should plug leakages, excesses and waste in all state-owned enterprises (SOEs), which historically have been a major source of fiscal risks, including in election years. The GNPC, as an example, has come under public scrutiny in recent times for excesses in its spending on Corporate Social Responsibility. Efforts at enhancing the efficiency of SOE spending will complement the wider effort to strengthen public financial management.

- The fundamental problem of fiscal rigidity, which is resulting in loss of fiscal maneuverability, sharp debt build-ups, large and rising debt service expenditure, and sharp reductions in public investment spending, has not seen significant policy redress other than the capping of earmarked transfers since 2017. The government has to take further bold steps to check the growth of compensation expenditure and debt service cost to generate fiscal space to fund productive public investment that will brighten the future prospects of the economy. In this regard, the IFS is pleased to announce that it will soon come out with a set of recommended strategies that can help the government address the compensation problem to create additional fiscal space.