Ghana: Recent Fiscal Challenges and Risks: What Should We Expect in 2016?

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5 November, 2015

1. Introduction

Ghana's medium-term development prospects look bright after nearly one decade of strong and broadly inclusive economic growth. However, large fiscal and external imbalances and macroeconomic instability have led to a slowdown of economic growth in the past two years. To address these imbalances and safeguard the bright medium-term prospects of the economy, the government embarked on its homegrown economic and financial program, but policy slippages, exogenous shocks, rising interest costs, and acute electricity shortages undermined the effort. Recognizing the need for strong reforms to achieve fiscal consolidation and debt sustainability, the government approached the IMF for support, which was granted in April 2015. The Fund's program aims at achieving fiscal consolidation and restoring macroeconomic stability to prepare the stage for the resumption of high and sustainable growth. After the first review of the implementation of the program, Ghanaians were told by both the government and the Fund that fiscal consolidation is on track and the macroeconomic situation in the second half of 2015 is expected to show significant improvement.

2. State of the Economy

Provisional figures released by the Ghana Statistical Service show that for the first quarter of 2015, the economy grew by 4.3 percent compared to a decline of 3.8 percent recorded for the same period in 2014. For the second quarter of 2015, real GDP expanded by 3.9 percent compared to the revised estimate of 2.6 percent for the second quarter of 2014 (GSS, September 2015). The GDP growth in the first quarter of 2015 was driven by growth in all the three main sectors. In the second quarter, however, real GDP growth was driven mainly by the industrial sector, which recorded the highest growth rate of 15.3 percent. Compared to the growth performance in the same period of 2014, the sectoral and overall GDP growth in the first half of 2015 showed a significant improvement. In terms of the sectoral distribution of the GDP, there was not much change between the first quarter and the second quarter of 2015, except that the industry sector overtook agriculture as the second major contributor to the country's GDP during the period.

Inflation remained higher than expected since the beginning of 2013, caused by the depreciation of the cedi, rising cost of credit, rising fuel prices, rising costs of non-oil imports, and rising cost of transportation and rent. Inflation rose steadily from 16.4 percent in January this year, reaching 17.9 percent in July before dropping marginally to 17.3 percent in August 2015. The upswing in inflation in the first eight months of the year was due to the depreciation of the domestic currency, fuel price adjustments, rising cost of credit, and other cost-push factors. The increase in inflation led the Bank of Ghana to revise the end-2015 inflation target from 11.5 percent set in the 2015 Budget to 13.7 percent. The policy rate of the Bank of Ghana, which had remained between 21 and 22 percent for eight months, was hiked to 24 percent in July 2015. In September, the policy rate and the interbank rate were merged and fixed at 25 percent in order to close the gap between the rates, according to the Bank of Ghana.

On the fiscal side, there was improvement during the first five months of the year, with the fiscal deficit coming in less than the target for the period, driven by improved revenue mobilization and expenditure containment. Total revenue and grants mobilized during the period was equivalent to 9.0 percent of GDP and 5.5 percent higher than the target for the period. Domestic revenue was 8.3 percent higher than the target for the period, caused largely by an increase in both oil and non-oil revenues, while actual grants received from development partners was 44.8 percent less than the budget estimate for the period.

Total expenditure (including arrears and tax refunds) during the first five months of the year was equivalent to 10.9 percent of GDP, which was 9.1 percent less than the target for the period. Almost all the expenditure items experienced significant underruns during the period. Excluding arrears payment, total expenditure was 8.0 percent lower than the target for the period.

With total revenue and grants rising in the face of declining expenditure, the fiscal deficit (on cash basis) dropped to 2.2 percent of GDP against a target of 3.4 percent of GDP. The deficit was financed mainly from domestic sources. Included in the domestic sources of financing the deficit was a drawdown of GH¢205.7 million from the Ghana Stabilization Fund attributed to shortfalls in oil revenue resulting from lower oil prices during the period. Foreign financing of the deficit amounted to 0.7 percent of GDP.

Ghana's total debt stock increased by GH₵10.5 billion or 13.3 percent during the first five months of 2015, pushing the total public debt stock to GH¢89.5 billion (67.1 percent of GDP) at end-May. By June 2015, the total public debt stock had reached GH₵94.5 billion, representing 70.9 percent of GDP. External debt totaled GH₵58.6 billion (44 percent of GDP) and domestic debt, GH₵35.9 billion (26.6 percent of GDP).

Despite the impressive fiscal performance achieved in the first five months of the year, the government revised the budget, citing developments in both the domestic and global economic environment as the main reason. In the revised budget, both revenue and expenditure estimates for the whole 2015 were cut, but revenue was cut more severely relative to expenditure, resulting in an overall fiscal deficit of 7.3 percent of GDP from the original estimate of 6.5 percent of GDP.

Interest rates on the money market in the first eight months of the year showed a mixed performance. Interest rates on the 91-day Treasury bills ranged between 25.1 and 25.6 percent during the period and the 182-day Treasury bill was between 25.9 and 26.4 percent. The interbank weighted average interest rate also ranged between 22.9 and 24.6 percent during the period.

The cedi weakened against the major trading currencies during the first nine months of the year as demand continued to outweigh supply. The cedi traded at GH₵4.33 to the dollar in June from GH₵3.20 to the dollar in December 2014, reflecting a year-to-date depreciation of 26.1 percent. By end-September 2015, the currency was trading at GH₵3.71 to the dollar on account of the expectation of some US$4 billion inflows, which were to provide a strong buffer and help to sustain stability in the foreign exchange market.

The trade balance during January to May 2015 was in a deficit of US$858.0 million, but increased to US$1,950 million at end-August 2015, driven by the continuous decline in exports, which outpaced the slowdown in imports. Although the current account deficit showed a declining trend during the period, the capital and financial account balance recorded huge deficits, causing the overall balance of payments to move from a surplus of US$397.1 million in December 2014 to a deficit of US$849.4 million in March 2015 and US$757.8 million in June 2015. Consequently, the level of gross international reserves dropped from US$5,461 million in December 2014 to US$4,539.7 million in June 2015, sufficient to provide cover for 2.9 months of imports.

3. Challenges and Risks

Economic Transformation

The Ghanaian economy still relies heavily on agriculture, which employs about half of the country's labor force, while manufacturing activities have been stagnating over the years. At the same time, exports are concentrated in three key commodities, namely gold, cocoa and oil, making the economy vulnerable to terms of trade shocks. The economy is also experiencing serious instability at the macro level, caused by the growing twin deficits and weak monetary policy. The characteristics of the economy point to the need for a serious transformation. Unfortunately, recent economic policies of the government are short of transformational ambition. The 2015 national Budget, which has as its theme "Transformational Agenda: Securing the Bright Medium Term Prospects of the Economy", did not explain the form that the proposed transformation will take, or the details of the drivers of the transformation process and the expected outcomes. It did not indicate how innovation and technology-led productivity growth will be pursued, how to transform the agriculture and manufacturing sectors to diversify the economy, and how to foster their inter-sectoral linkages. The budget did not address a number of issues and risk areas with strong policies, strategies and innovative solutions, leaving the transformation process and outcomes in the hands of good fortune.

The fact is that, the underlying structure of the Ghanaian economy is weak, reflected in a narrow production base, over-dependence on few primary and unprocessed export commodities, weak manufacturing base and high import dependence. This has tended to stifle economic growth and development, and manifested in general economic and financial imbalances. The country's foreign reserve position is weak alongside mounting public debt. High interest rates and a volatile currency have depressed private sector activity, and spreads on the country's Eurobonds have risen above those of regional peers.

With the government putting a freeze on employment into the public service (excluding education and health) and non-replacement of departing employees in overstaffed areas, the burden of job creation falls on the private sector. Yet, economic policies of the government do not provide concrete evidence that private businesses can expect to become more profitable and grow in scale and scope required to create the jobs needed. The risk here is that the large and growing number of unemployed youth and graduates is a time bomb waiting to explode in the country.

Informal Sector

A significant portion of the Ghanaian workforce is also engaged in the informal economy. According to the last GLSS, 42 percent of all employed persons that are more than 15 years old are engaged in the private informal sector, while an additional 46 per cent are engaged in agri-business. Unfortunately, activities in the informal economy are not fully recorded and are not taxed at all or are only partially taxed, resulting in not only loss of revenue to the government but also ineffective regulation, unreliability of statistical information and inability to monitor this large portion of the economy. Although the government is attempting to address the challenges of the informal economy by streamlining certain regulations and bringing the entire informal economy into the formal sector, the pace of the effort is very slow

Infrastructure Deficit

Ghana faces huge backlogs of infrastructure, including roads, railways, ports, utilities, power sources, water supply. Many economic activities in the country, including agriculture, mining, processing, development and exploration, depend to varying degrees on inadequate infrastructure. According to the World Bank's "Africa Infrastructure: Country Diagnostic, 2010 Report", Ghana needed US$2.3 billion annually over ten years to address its infrastructure deficit. Although the government has implemented a number of projects to address the infrastructure gaps identified in the report, it still has not been able to achieve its infrastructure targets due to a number of factors, including labor inefficiency, inadequate resources and equipment failure. As a result the gaps in infrastructure continue to constrain the country's overall economic growth.

Power shortages also continue to negatively impact the country's economic growth. Ghana has a total installed power capacity of 2,956 megawatts but currently, only one-third of the total hydro capacity is available for utilization. This has resulted in "load shedding" of 24-hour blackouts followed by 12 hours of supply, which has contributed seriously to the cost of doing business. Power rationing in the country has forced some mining companies in the country to reduce their electricity usage from the national grid, which in turn has adversely affected production and tax revenue. Manufacturers and other businesses have had to face the cost of increased use of generators and thermal sources of energy. Power shortages are indeed having a significant toll on industrial production and adversely affecting the country's budgetary position by increasing expenditures and causing a slower economic growth.

It is encouraging to note that oil and gas from the Tweneboa-Enyenra Ntomme (TEN) Fields, the Western Corridor Gas Infrastructure project, the Atuabo Gas Processing Plant, and the Sankofa Gas Project will come on stream very soon. The government has also signed an agreement for the development of natural gas reserves of the Offshore Cape Three Points. The coming on stream of these projects should bring to an end the current power outages that are seriously constraining economic growth.

Fiscal Challenges

Ghana has recorded double-digit fiscal deficits since 2012 and this situation is having an adverse effect on the economy and its ability to service its debt. On the revenue side, there are a number of challenges and risks to contend with. First, domestic revenue accounted for about 97.3 percent of total revenue and grants during the first five months of the year. This implies that total government expenditure depends precariously on domestic revenue. A decline in domestic revenue therefore has serious consequences for fiscal management as we saw with the recent decline in oil revenues. Second, disbursement of grants by development partners has been very low since 2009 notwithstanding the implementation of the IMF-support program. This suggests that development partners do not release funds because of the existence of an IMF program, as there are still other conditions for disbursement. Grants from development partners have declined sharply in recent years, from GH₵1.2 billion in 2009 to GH₵787.3 million in 2014, and only GH₵325.1 million of grants was released during the first five months of this year. This should serve as a wake-up call to the country's fiscal managers.

Expenditure management also faces a number of challenges and risks. First, the major cause of the expenditure containment during the first five months of this year was the huge under-expenditure on compensation of employees, transfers to government agencies, interest payment, and arrears. Since all these expenditures except arrears are in a way statutory obligations, their under-spending implies a creation of potential new arrears.

Second, even with the recorded under-spending, compensation of employees still accounted for 41.3 percent of total domestic revenue during the first five months of the year. Together with interest payments and transfers to other government units, the three expenditure items consumed 89.7 percent of the total domestic revenue during the period. Compensation of employees, interest payments and transfers together also accounted for 72.1 percent of the total expenditure in the first five months of the year, pointing to the rigidity in the national budget.

Quite clearly, further increases in wages and salaries will greatly undermine the fiscal consolidation effort of the government, increasing the fiscal deficit and crowding out spending on much-needed infrastructure and social protection. On the other hand, any adjustment that impacts negatively on wages and salaries of civil servants could lead to protests, demonstrations and strikes, which in turn will weaken the economy further. For now, the government has sought to contain pressures on wages by taking a number of measures to lower the public sector wages to tax revenue ratio. A failure to complete negotiations of public sector wages prior to finalization of the 2016 budget could lead to increases in expenditure and a further increase in the budget deficit.

Third, the current level of interest payments by the government has the potential to crowd-out public investment with serious consequences for economic growth. We all know that if economic growth slows down, revenues would be impaired, deficits would rise and so would government debt.

Fourth, the fiscal outlook still poses serious challenges for debt sustainability as the country is already at a high risk of debt distress on account of unfavorable trends in the country's debt service relative to domestic revenues and also to export earnings. This again poses serious headwinds to economic growth this year and the medium term.

Macroeconomic Challenges

The behavior of almost all the key macroeconomic indicators does not appear to support the view that the macro-situation for the rest of 2015 would improve. With the current high interest rates, rapid depreciation of the cedi, and deregulation of petroleum product prices, the upswing of inflation is likely to remain for the rest of the year. The fall in prices of the country's main export commodities and the resultant potential loss of foreign exchange and revenue to government may also continue. The recent relaxation of capital controls will have a short term palliative effect on the cedi weakness, but with serious downside implications for the country in terms of increasing its vulnerability to external shocks.

Ghana returned to double-digit inflation in 2013, driven by currency depreciation, pass-through effects of the adjustment in fuel and utility prices, and fiscally-driven demand pressures. Since the current high inflation in the country seems to be mostly cost-push, with the soaring interest rates and the exchange rate depreciation as the main channel by which the fiscal pressure causes inflation, it seems inappropriate for the Bank of Ghana to continue fighting inflation by increasing the policy rate, which eventually leads to increases in other interest rates. Even if fiscal consolidation takes hold and contributes to keep down domestic demand and pressure on interest rates and the exchange rate and thus reduce inflation, other drivers of inflation such as food, fuel and utility prices are hard to predict. The inflation upswing is therefore likely to continue in the remaining period of the year, especially with the deregulation of petroleum product prices.

There is also no concrete assurance that the pressure on the cedi will abate before the end of the year. As it is well known, the weakness of the domestic currency is a result of the macroeconomic imbalances, in terms of large fiscal and current account deficits leading to mounting public debt and rising interest rates. As has been pointed out earlier, the balance of payments support is not too strong to have strong positive impact on the domestic currency. The fear therefore is that the worst of the cedi depreciation is yet to come.

The External Sector and Exports Diversification

In the face of the falling prices of the country's key export commodities and the resulting potential loss in foreign exchange and revenue to the government, the country has remained a huge importer of both intermediate goods and household consumables, with very little to offer in local manufacturing. This undesirable situation has seriously constrained the country's ability to both accumulate and conserve foreign exchange reserves, thus putting the cedi under excessive pressure.

There are also other important challenges to contend with in the attempt to strengthen the country's balance of payments position. First, the country's current account deficit has inherent structural weaknesses, making one to think that the projected sharp reduction in the current account deficit over the medium term may not materialize. A view is also held that significant oil and gas industry-related imports as well as the continuing high consumer goods imports that may come on stream during the rest of the program period may put pressure on the current account deficit. Second, the policy of unbridled trade liberalization has compelled the country to live virtually on imports. The increasing appetite for imports means that the demand for foreign currency, especially the US dollar, is growing exponentially, putting pressure on the cedi exchange rate and a number of jobs being lost. And with the value of the cedi depreciating on a daily basis, domestic prices of imports keep on rising with adverse implications for living conditions of Ghanaians with fixed incomes.

Public Debt

A major challenge to maintaining macroeconomic stability and growth in the country is related to the rising public debt in recent years. The debt-GDP ratio is not only rising astronomically but has already reached a level considered to be above the sustainability threshold, posing serious headwinds to economic growth. Assuming no roll-overs and refinancing, US$8.5 billion is required to service the country's domestic and external debt in 2015, and between 2015 and 2020 a total of US$21.2 billion will be required to service the country's total debt. The public debt is also concentrated at the short-term end of the market, putting pressure on the budget from the high rate and high cost of refinancing. Although the government hopes to lengthen the maturity profile of the public debt stock by actively increasing the share of longer-duration foreign debt in the portfolio, this comes with a price.

Restoration of macroeconomic stability is also constrained by the level and composition of the country's public debt. Total public debt has risen to 70.9 percent of GDP at end-June 2015 and amortizations have almost doubled from what they were three years ago. Amortization of short term domestic debt has reached the equivalent of 31 percent of GDP (World Bank, 2015). Hence, the debt composition has become a major source of risk, trapping the authorities in a vicious circle of short maturity high risk currency depreciation-high debt levels. This underscores the call to the government to slow down borrowing, especially borrowing from foreign sources unless the borrowed funds are used to finance projects that can generate funds within a reasonable time period to pay off the debt.

The deteriorating fiscal position and the adverse debt dynamics fueled by high domestic interest rates and currency depreciation against the major international currencies are extremely disturbing. Without measures to smooth the amortization of the 2013 Eurobond, the 2023 bullet repayment may result in a breach of the indicative external debt service-ratio. The issuance of the 2014 Eurobond at the coupon rate of 8.125 percent could also lead to a breach in three consecutive years in the absence of measures to smooth the amortization profile. It also needs to be recognized that the current financing conditions of the international market have become tighter and costly for the country. The expected hike in the value of the US dollar and interest rates have made it more costly to borrow from foreign capital markets, especially as the country's currency continues to depreciate against the dollar. It is believed that the high coupon rate of 10.75 percent for the September US$1.0 billion Eurobond is a reflection of the weakening investor appetite for and loss of confidence in the country's debt because of the lingering doubts about long-term macroeconomic stability and public financial sustainability. High levels of debt, interest costs and continued borrowing may have serious negative impact on the country's sovereign credit rating, impairing the country's ability to service its debt. .

Corruption in the public sector

A number of Ghanaians perceive the public sector as corrupt. A large majority of Ghanaians are also of the view that corruption has increased in recent years, and that the government has performed poorly in fighting this destructive canker in the country. The perception of deepening corruption in the public sector seems to be confirmed by the numerous scandals that have recently hit public institutions, public servants and political office-bearers. Huge funds have allegedly been misappropriated through the implementation of programs and projects and other dubious judgment debts paid by the government are yet to be retrieved. While corruption in high places is worrying, it is dreadful that institutions that are charged with maintaining peace, law and order and nurturing democracy in the country are increasingly gaining dishonor for corrupt practices. Ghana is ranked 61 out of 175 countries in Transparency International's 2014 Corruption Perceptions Index. Although the government has implemented and is currently pursuing major initiatives to prevent and fight corruption and unlawful enrichment, corruption remains a significant issue in the country.

4. What should we expect in 2016?

First, as has been pointed out by the IFS (July 2015; December 2014), what seems to be missing in the economic strategies of the government is the recognition of the fact that while there can be growth without economic transformation, there can never be economic transformation without growth. High and sustained growth is very critical for economic transformation. To achieve this, macroeconomic stability will have to be established and entrenched in the country through the implementation of sound fiscal policies and the building of strong buffers and mechanisms to manage risks. The resulting low inflation, currency stability, and low interest rates will make capital more affordable for firms and reduce business risks.

Second, the centrality of the private sector in economic growth and transformation should also be acknowledged, and the government's role in supporting the private sector to this end should be viewed as critical. A clear strategy to expand business firms' access to credit, access to domestic and international (export) markets, reduce business risks and the soaring interest rates, and create a conducive business enabling environment is required to support the development of the private sector.

Third, to transform the economy through diversification will require significant infrastructure investment and hard work to remove the main bottlenecks to growth, mainly lack of affordable financing, inadequate electricity supply, and poor transport infrastructure. To sustain high growth targets, government will have to scale up investment spending, accompanied by significant private sector participation. This is where we find the recently established Ghana Infrastructure Fund playing a critical role. The government may also want to establish a guarantee facility that provides risk mitigation and credit enhancements to support long-term infrastructure development.

Fourth, given the high level of public debt, there is an urgent need for a well-grounded fiscal framework to anchor fiscal policy and guide it toward the achievement of the medium-term objectives. Bringing down the fiscal deficit will require taking strong measures to enhance domestic revenue mobilization and continuing to plug revenue leakages arising from exemptions, under-invoicing, bonded warehousing facility, transit goods, auction of confiscated goods, export processing zones, etc. The real challenge though is whether the government will be able to demonstrate fiscal prudence in the run-up to the 2016 elections.

Fifth, to strengthen export diversification to improve the trade balance and generate more foreign exchange to support the cedi, government should provide greater targeted support to industries with vast export potential, such as agro-processing, clothing and pharmaceuticals. The success of these initiatives will bolster the performance of the external sector over the medium- to long-term and reduce the vulnerabilities arising from the perilous dependence on a few commodity exports. The country needs policies and programs that reward domestic production and penalize imports that can easily and efficiently be produced locally. Such policies may include expanding business firms' access to credit and international (export) markets, reducing business risks and the soaring interest rates, creating a congenial business environment, and dealing with the energy crisis and transportation problems. In this regard, the government's industrial policy that aims at providing support for the land reform process and the enhancement of labor productivity through the application of new technologies is most welcomed and should be pursued relentlessly. There should also be a complete overhaul of the trade policy through the introduction of targeted demand-side measures that aim at reining in excessive and unproductive import demand while contemporaneously reallocating fiscal resources away from the ballooning wage and interest outlays towards long-term growth propelling capital investment and infrastructure.

Finally, on the issue of corruption, we expect heads of public institutions and their staff to see corrupt practices and behaviors as unacceptable. The government should outline a comprehensive action plan to root out the practice, which is seriously undermining development plans in the country.

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