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Evaluation of the IMF Board's Second Review of Ghana's Extended Credit Facility-Supported Program

Introduction

The Institute for Fiscal Studies (IFS) has followed the IMF program since its inception in April 2015. Our interest has been to ensure that the program effectively supports growth, job creation and poverty alleviation in Ghana.

In January 2016, the IMF Board conducted a second review of Ghana's IMF-supported program which spans 2015 – 2017. The IFS has conducted an evaluation of this review.

The immediate objective of the program, which is backed by a US$916.8 million credit facility, is to restore macroeconomic stability and debt sustainability, which had been severely eroded in the past few years. In its review of the program, the IMF Board revised key macroeconomic targets, including growth, inflation, the budget deficit, public debt and current account deficit. The Board expressed broad satisfaction with the implementation of the program, although it considered the economic outlook to remain difficult. It cited potential risks to the program to include: tight financing conditions, global financial market volatility, sustained decline in Ghana's key commodity prices and possible prolongation of the energy crisis.

Our Key Observations and Recommendations

Following our evaluation, the IFS made the following key observations and recommendations:

1. Overall, the tone of the IMF Board review is more optimistic than the real situation suggests. In fact, the decision to revise key macroeconomic targets is a clear indication that the program has encountered challenges.

2. The revisions made are in the right direction because they generally vindicate the Institute's earlier view that many of the original targets were unrealistic, largely because they were ambitious, and needed to be revisited. IFS considers most of the new targets to be more realistic. However, the new targets suggest that macroeconomic instability will remain prolonged. Also, economic growth will be suboptimal because: i) it is below recent historical average, and ii) it is unbalanced because it is driven largely by services and also

extractives. Because extractives in particular are highly capital intensive, they do not normally generate enough jobs.

3. There is lack of enough attention in the program to growth-enhancing policies. Unfortunately, this is typical of IMF-supported programs that tend to focus on demand-management policies aimed at addressing lingering macroeconomic instability. The Institute particularly calls for concrete interventions to support agriculture and manufacturing, which have the potential to generate more jobs.

4. There are shortcomings in inflation management. This is because the Bank of Ghana seems to over-rely on demand-management tools to tackle a problem that is essentially supply- or structurally-driven. The Institute advises the Bank to broaden its arsenal of instruments so as to be able to carry out its mandate more effectively. In particular, given the range of factors that affect inflation—both supply and demand factors—reliance on the Policy Rate alone may not be sufficient and may have to be supported by other instruments. For example, better coordination of monetary policy and government's overall economic policy is an important instrument in fighting inflation. The use of the current "macro-approach" should be supplemented by a "micro approach," i.e. one aimed at the real sources of inflation, such as food supply, administered prices and the exchange rate. This will make the fight against inflation more effective.

5. The new Bank of Ghana Act should carefully balance the Bank's independence with its accountability in line with international best practice.[1] Thus, while there is a need to strengthen the Bank's monetary policy autonomy, it is important that monetary policy supports the overall policy of government as the elected manager of the economy. Further, in a developing country context such as Ghana's, where the domestic debt market is underdeveloped, it is necessary for the central bank to be ready to provide some, albeit limited, financial accommodation to government when needed. Therefore, the proposal in the new Act to eliminate completely Bank of Ghana lending to government starting from 2016, except in extreme emergency cases, may be premature. We should have started with a lending ceiling of 5% of government revenue (compared with the previous limit of 10%, which also included government borrowing from the rest of the economy).

6. Deepening the forex market is important in reducing exchange rate volatility. However, the proposal by the IMF to phase out compulsory surrender requirements could increase the pace of foreign exchange leakages (or outflow) through the financial system, especially

[1] The IFS has presented its views on the proposed Bank of Ghana Act for the consideration of the authorities in a paper: ***"Amending the Bank of Ghana Act, 2002 (Act 612)?"***

in light of substantial foreign ownership of the banking sector. To avoid this, it is important for Bank of Ghana to acquire the necessary supervisory capacity to be able to effectively police the system.

7. Managing the foreign exchange market alone cannot bring lasting solution to the perennial pressure on the cedi. The issue is how to generate enough foreign exchange to pmeet the high and growing demand. The problem—and the solution—lies in the structure of the economy that produces low-value-added primary products, whose prices are dictated in world markets, coupled with overreliance on imports due to the low domestic industrial production capacity. Addressing the exchange rate problem on a durable basis calls for transformation of the economy from its "colonial structure" through export diversification and value addition in conjunction with a strong domestic industrialization drive to foster production of wide-ranging import substitutes.

8. The Institute is in agreement with the IMF Board—and staff—that strict adherence to the program's fiscal consolidation path is critical to re-stabilizing the economy and placing it on a path of sustained growth. However, the pursuit of fiscal consolidation should be mindful of the potential impact of the accompanying measures like tax increases, employment freeze and elimination of consumer subsidies on the poor and appropriate compensatory measures should be introduced. The Institute recognizes that strict fiscal consolidation will be a difficult task in election year 2016, given Ghana's record of election-cycle spending and deficit overruns. The Institute recalls government's stated commitment to avoid the election-year fiscal syndrome and urges it to honor its promise in that regard so as to avoid plunging the economy into another post-election crisis that might necessitate an unwarranted return to the IMF.