INSTITUTE FOR FISCAL STUDIES

POLICY BRIEF No.19

REVIEW OF THE GOVERNMENT OF GHANA'S 2023 MID-YEAR BUDGET AND FISCAL POLICY DIRECTION IN THE FACE OF THE CURRENT FISCAL AND MACROECONOMIC CRISES

1. INTRODUCTION

The mid-year review of the 2023 budget statement presented to Parliament by the government of Ghana at the end of July 2023 provided, among other things, a critical update on the government's fiscal policy performance in 2022 and the first half of 2023. It also revised budget estimates for 2023 to reflect happenings in the first half of the year and to align key fiscal targets to the IMF program secured in May 2023.

In this brief paper, we critically analyze the mid-year budget, focusing on the reported fiscal outcomes for 2022 and the first half of 2023 and the revisions made to the 2023 budget. After outlining a number of comments regarding the performance and direction of fiscal policy, we offer recommendations as to how best the government can set its fiscal policy on a firmer path.

2. Analysis of Fiscal Performance in 2022 and the First Half of 2023

2.1 Fiscal Performance in 2022

The government's fiscal performance in 2022 was notably poor, with a considerable increase in the budget deficit relative to target, due to a combination of underperformed revenue and significant overspending. Total revenue and grants was GH¢96.65 billion in 2022, which was GH¢3.87 billion lower than the original budget target of GH¢100.52 billion. It was also GH¢1.43 billion short of the projected outturn of GH¢98.08 billion announced in November 2022 when the 2023 budget statement was presented to Parliament. With this performance, total revenue and grants was equivalent to 15.8% of GDP in 2022, which is 4.2 percentage points less than the original budget target of 20% of GDP.

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At GH¢165.06 billion, total government expenditure on commitment basis in 2022 exceeded the original budget target of GH¢135.63 billion by as much as GH¢29.43 billion or 21.7%. It was also higher than the 2022 mid-year budget target of GH¢133.84 billion by as much as GH¢31.22 billion or 23.3%. Even when compared with the projected outturn of GH¢159.01 billion announced in November 2022, when the year had almost ended and the government was supposed to have a firm knowledge of was going on with spending, the actual expenditure is higher by GH¢6.05 billion.

With these revenue and expenditure outturns, and despite the government's repeatedly proclaimed strategy of fiscal consolidation, the actual budget deficit on commitment basis increased to a whopping GH¢72.20 billion, or 11.8% of GDP, from an original budget target of GH¢35.11 billion, or 7% of GDP, and a mid-year budget target of GH¢37.0 billion, or 6.3% of GDP. This means the actual deficit-to-GDP ratio recorded in 2022 was as much as 4.8 and 5.5 percentage points higher than the 2023 original and mid-year budget targets, respectively. In cash terms, the budget deficit in 2022 hit 10.7% of GDP relative to the original and mid-year budget targets of 7.4% of GDP and 6.6% of GDP, respectively, and up from an outturn of 9.2% of GDP in 2021.

2.2 Fiscal Performance in the First Half of 2023

In the first half of 2023, revenue continued to perform below target, as the government collected total revenue and grants of GH¢59.3 billion or 7.4% of GDP, which is GH¢5.42 billion short of the targeted amount of GH¢64.72 billion or 8.1% of GDP. All the major revenue components, with the exception of non-oil tax revenue, performed below target, with oil and gas receipts recording the biggest shortfall of GH¢5.78 billion or 49.3% relative to the target of GH¢11.73 billion.

At first glance, expenditure performed better in the first half of 2023. This is because total expenditure outturn on commitment basis in the first half of 2023 was GH¢68.51 billion (8.6% of GDP), which was GH¢24.49 billion or 26.3% lower than the budgeted amount of GH¢93.0 billion (11.6% of GDP).

Due to the expenditure undershoot, the budget deficit on commitment basis in the first half of the year was significantly below target, as it stood at GH¢6.30 billion (0.8% of GDP), against the target of GH¢28.28 billion (3.5% of GDP). The cash deficit also stood at GH¢10.34 billion or 1.3% of GDP, against the target of GH¢35.49 billion or 4.4% of GDP.

However, the drivers of the expenditure undershoot were (1) lower interest payment, largely due to the suspension of foreign debt service payment since the start of the year, but also reflecting savings from the domestic debt exchange program, and (2) a sharp decline in capital expenditure. Compared to the target of GH¢28.59 billion, actual interest payment was GH¢15.14 billion, thus representing as much as GH¢13.44 billion or 47% lower than the budgeted amount. Capital expenditure also declined by GH¢8.69 billion or 47.6% from an initially budgeted amount of GH¢16.60 billion to an actual outturn of GH¢7.91 billion. Yet, the decline in interest payment during the first half of 2023 does not provide much cause for celebration, as it is expected that the suspended interest payment in the first

half of the year will largely have to be settled during the second half of the year, implying that the decline in total expenditure resulting from the sharp decline in interest payment may only be transitory or temporary. Also, a decline in capital expenditure as a means of expenditure adjustment is counterproductive, as it is bad for long-term economic growth.

3. The Revised Budget for the 2023 Financial Year

The revised budget estimates for 2023 indicate the following:

First, the revenue underperformance in the first half of 2023 is expected to persist through the entire year. Specifically, total revenue and grants for 2023 has been revised downwards from GH¢143.96 billion to GH¢134.91 billion (thus by GH¢9.04 billion or 6.3%), driven by significantly lower oil and gas receipts. The adjusted revenue estimate is equivalent to 15.8% of GDP, the same as in 2022, and thus less than the original budget target of 18% of GDP by 2.2 percentage points.

As stated earlier, the revised budget for 2023 shows that the large decline in total expenditure of 26.3% during the first half of the year may not be permanent, as total expenditure on commitment basis for the entire year is now expected to decline by only 3.7% (from the initially budgeted amount of GH¢190.91 billion to GH¢183.86 billion). This is because the 47% decline in interest payment in the first half of the year is expected to shrink to only 14.6%. Also, capital expenditure, which reduced by 47.6% in the first half of 2023, is expected by the government to reduce by only 23.0% for the entire year.

In fact, with compensation of employees expected to increase by the end of 2023 by GH¢5.82 billion to GH¢51.35 billion against the target of GH¢45.52 billion, total primary expenditure on commitment basis for the entire year is even expected by the government to increase marginally.

Since the reduction in total expenditure on commitment basis is not sufficient to offset the revised total revenue and grants shortfall, the budget deficit on commitment basis is expected to increase by GH¢2.0 billion from the original figure of GH¢46.96 billion to a revised figure of GH¢48.95 billion. Thus, the budgetary figures for the entire year of 2023 show that the seeming fiscal improvement during the first half of 2023 is no cause for celebration.

4. Comments

I. On Revenue

One would find it puzzling that revenue mobilization continues to be a major problem for the government. The reason is that a range of strategies have vigorously been pursued in the last six years in order to boost government revenue substantially.

First, in what was billed as a shift from "taxation to production", the government adopted a strategy of tax cuts to spur economic growth, from which it hoped to generate more tax revenue. To this end, the 2017 budget granted a range of tax incentives and reliefs. These included abolition of VAT/NHIL on financial services, real estate, domestic airline tickets, and selected imported medicines, as well as abolition of excise duty on petroleum, removal of import duty on spare parts,

and cancellation of capital gains tax on publicly held securities. The rates of the special petroleum tax, national electrification scheme levy, and public lighting levy were also reduced.

Second, from the second half of 2018, however, as revenue was performing below expectations, the government dramatically reversed strategy and began to raise taxes and levy new ones. This tax-raising strategy has since then dominated the government's revenue policy. Thus, over the period, the government has, among other tax measures, (i) raised the top marginal income tax rate from 25% to 35%; (ii) increased the VAT standard rate from 12.5% to 15%; (iii) raised excise duty on mineral water, drinks, and cigarettes; (iv) introduced a financial sector clean-up levy; (v) imposed a Covid-19 health levy; (vi) imposed a pollution and sanitation levy; (vii) introduced an electronic transactions levy (E-levy); and (viii) extended the previously narrowly applied fiscal stabilization levy (now called the growth and sustainability levy) to all sectors.

Third, the government has pursued a number of revenue mobilization reforms since 2017. These include: (a) passage of legislation to limit tax exemptions; (b) launching of a Revenue Assurance and Compliance Enforcement (RACE) initiative to tackle revenue leakages; (c) introduction of VAT flat rate; (d) a more vigorous implementation of the Excise Tax Stamp Act (2013); and (e) others. To broaden the tax base and improve compliance, a number of digitalization reforms have also been implemented. These include (i) the national ID system; (ii) national digital address system; (iii) unified common property rate platform; and (iv) online tax filing.

In spite of all these efforts, which built upon previous governments' revenue mobilization reforms, total revenue and grants has continued to perform poorly as demonstrated earlier. Indeed, the 2023 mid-year revised budget estimates show that the revenue-to-GDP ratio will stagnate at 15.8% of GDP this year. Clearly, the tax-centred revenue mobilization strategy is failing to help Ghana to improve government revenue generation. In fact, this 15.8% of GDP is 4.7 percentage points lower than the average for African countries of 20.5% of GDP and 6.2 percentage points lower than the average for middle income countries of 22.0 of GDP, which the IFS found in a study in 2020. A new approach to revenue mobilization in Ghana is, therefore, critically needed to turn things around.

II. On Expenditure

As analyzed above, the saving in interest payment, which served as the main driver of the sharp expenditure decline in the first half of 2023, was only transitory, as the overall revised budget for 2023 revealed that the government expected debt repayment to resume in the second half of the year. However, it is expected that after the completion of the foreign debt restructuring, some significant savings in interest payment would still be made, if even foreign debt repayment resumes. Nevertheless, what will make the savings in interest payment be more significant and thus have a substantial effect on total expenditure is if the government is able to secure substantial debt forgiveness regarding the external debt. This would improve the country's public finances on long basis.

However, it should be understood that while savings on debt service resulting from the ongoing debt restructuring is a good thing, we cannot fully count on it. The reason is that if the government is not prudent on non-debt service expenditures, reliefs provided by declines in debt service spending become short-lived, since growths in the non-debt service expenditures, largely due to fiscal populism, would lead to increased borrowing again. This would return the country to fiscal distress and crises. This is what exactly happened after the country gained considerable reliefs on debt-service expenditure and thus significant fiscal space from the HIPC debt-relief initiative in the 2000s.

The government has to, therefore, concurrently pay serious attention to troubling non-debt service expenditures like compensation of employees and goods and services, which houses most of the expenditures on the government's flagship programs. Yet, the 2023 revised budget shows that compensation of employees, for instance, continues its upward trajectory, as, in addition to its outturn in 2022 exceeding the budgeted amount by GH¢3.7 billion, its value for 2023 is expected to increase by as much as GH¢5.82 billion to GH¢51.35 billion against the target of GH¢45.52 billion. This shows that the government is not credibly committed to a strong and effective fiscal consolidation, which is not only needed to respond to the deep economic crisis the country continues to face, but it is also needed to produce long-lasting fiscal benefits. The government is clearly counting on only savings on debt-service costs from the debt restructuring as the solution to the fiscal and macroeconomic crises at hand, which, as argued above, should not be so.

5. Recommendations

I. Adopt a new revenue strategy centered on the extractive sector. As we have constantly argued, and given the failure of the tax-centred strategy to rapidly improve revenue mobilization, the government must turn to the extractive sector, where the potential to generate substantial additional public revenue is enormous. Indeed, IFS' research has calculated that were Ghana's extractive sector revenue to match the middle-income average, the country would boost its total revenue and grants by 4.4 percentage points of GDP. Even more, were the country's mining sector revenue to match Botswana's and oil sector revenue to match Nigeria's, total revenue and grants would **increase** by as much as US$4.32 billion or 6.6 percentage points of GDP, bringing revenue to GDP ratio from the current 15.8% to as high as 22.4%. To realize this, the Ghanaian government must do as is done in Botswana and Nigeria by pursuing majority state participation and ownership in the oil and mining sectors. Alternatively, the fiscal regimes in the oil and mining sectors can be switched to production sharing agreements, as studies[1] at IFS have found that the poor revenue generation from the oil and mining sectors is the result of the current royalty-tax fiscal instruments under the concession regime Ghana employs. Indeed, a new revenue strategy centered on the extractive sector is long overdue. We, therefore, urge the

[1] *See IFS' Occasional Paper No. 24: Boakye (2020), "The Role of the Extractive Sector in Ghana's Comparatively Low Public Sector Revenue Mobilization", https://www.ifsghana.org/wp-content/uploads/2021/08/occasional-24.pdf*

government not to miss this opportunity as it prepares the Medium-Term Revenue Strategy (MTRS) as part of its current program with the IMF. Clearly, Ghana cannot be number 1 producer of gold in Africa and number 6 in the whole world according to data from World Gold Council while it struggles to raise budgetary revenue, which is significantly contributing to the repeated fiscal distress the country experiences. We should not continue to allow private sector actors to enrich themselves at the expense of the state from publicly endowed resources from God.

II. Negotiate for significant debt cancellation as part of the external debt restructuring. Given that Ghana has not yet reached a deal with creditors on its foreign debt renegotiations, the government has to push for significant foreign debt cancellation. This is because, as stated earlier, savings in interest payment would be more significant and have a substantial effect on total expenditure, and thus improvement in the country's public finances on longer-term basis, if the government is able to secure substantial debt forgiveness regarding external debt.

III. Do not bank on debt restructuring alone to fix the country's fiscal problems. As stated earlier, the government should understand that debt service savings, through restructuring of liabilities, would not alone rescue the country from the current fiscal quagmire on a permanent basis. What would do so, apart from more robust revenue generation, is a fundamental and radical reform of total public spending, including, of course, significantly curtailing compensation expenditure[2] as well as expenditure on fiscally populist social programs that harbor significant inefficiencies and deadweight losses. To this end, the government must expedite the review of its flagship programs, which is a structural conditionality under the current IMF program, and take concrete action to reduce expenditures on these programs to ensure a strong and effective fiscal consolidation that would help lift the country out of the current fiscal hole.

[2] *For specific and detailed strategies to rein in compensation, see IFS Occasional Paper No. 22: Boakye (2019): "Ghana's Large Public Sector Compensation Bill: Agitations, Policies, Implications, Causes & Recommendations", https://www.ifsghana.org/wp-content/uploads/2021/02/Occasional-22-pdf-4-2.pdf*

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