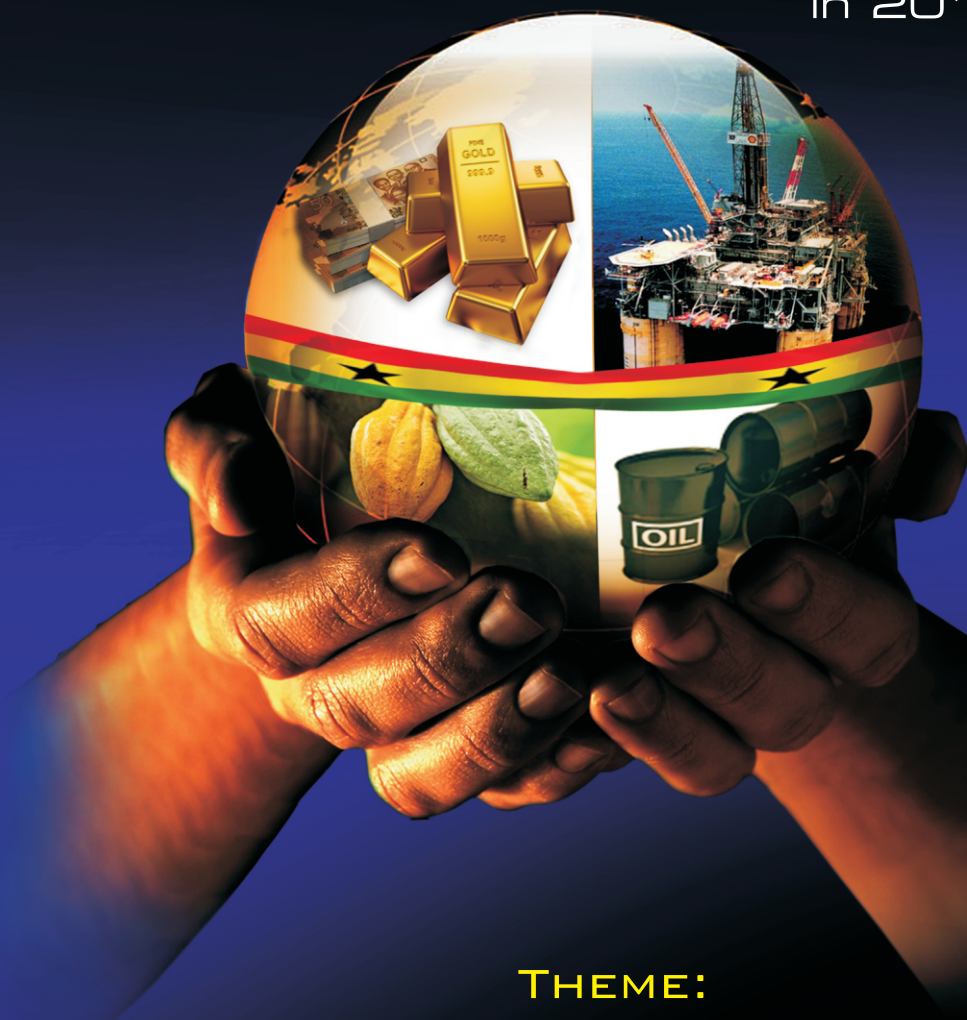


**IEA
Ghana**

THE INSTITUTE OF ECONOMIC AFFAIRS
A Public Policy Institute

A Review of the
Ghanaian Economy
in 2013-2014



THEME:
Ghana's Public Financial Management

The Ghanaian Economy: Annual Review 2013-2014

Theme: Ghana's Public Financial Management

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ACRONYMS AND ABBREVIATIONS

ABB	Activity Based Budgeting
ASYCUDA	Automated System for Customs Database
BoG	Bank of Ghana
BPEMS	Budget and Public Expenditure Management System
CAGD	Controller and Accountant General Department
ERPFM	External Review of Public Financial Management
FAA	Financial Administration Act
FAR	Financial Administration Regulation
GIFMIS	Ghana Integrated Financial Management Information System
GoG	Government of Ghana
GRA	Ghana Revenue Authority
HIPC	Highly Indebted Poor Country
IAA	Internal Audit Agency
IFMIS	Integrated Financial Management Information System
IPPD	Integrated Payroll and Personnel Database
MDA	Ministries, Department and Agencies
MMDAs	Metropolitan, Municipal and District Assemblies
MTEF	Medium Term Expenditure Framework
MOFEP	Ministry of Finance and Economic Planning
NETS	National Expenditure Tracking System
ODI	Overseas Development Institute
OOB	Output Oriented Budgeting
PBB	Programme Based Budgeting
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PPA	Public Procurement Authority
PUFMARP	Public Financial Management Reform Program
SMTDP	Sector Medium Term Development Plan
TSA	Treasury Single Account
WAN	Wide Area Network

1. INTRODUCTION AND OVERVIEW

The subject of Public Financial Management (PFM) continues to engage the attention of every political regime for nearly three decades, for one simple reason. From revenue mobilization to spending controls and accountability, deficiencies in PFM underlie the litany of Ghana's fiscal management problems. After the excitement of the Rawlings revolution in the early 1980s, managing the public purse would become one of the central themes of economic reform because it is indispensable to effective executive government. To this end, a series of reform measures were launched to rebuild the machinery of mobilizing and managing the public purse for the public good.

As the process by which governments manage the public resources in line with the Directive Principles of State Policy of the 1992 Constitution, sound public financial management would become a key mechanism for governments to meet the socio-economic objectives for all citizens. And citizens expect public resources in the government's care will be treated with respect.

The main constituents of sound public finance management are efficient mobilization of tax revenues, planning and programming of the use of all the resources made available for development, budgeting and its execution, forecasting cash flow, controlling and tracking spending, monitoring and accounting for the use of communal resources of the state, auditing and evaluating what governments at all levels and all public institutions are doing with these resources, and prudently managing the public debt.

PFM for too long hanged on to structures, systems, procedures and instruments which though may have been adequate in the immediate post-independence era, had increasingly become limited in the efficient management of public resources as the economy grew more complex, information-rich, knowledge intensive, and with it the complexity of government transactions. After a succession of piecemeal reforms which begun in the late 1980s, an integrated financial management system using information technology to keep track of various financial transactions of the public sector was launched in July 1995.

Key to achieving the desired goals were (a) the transformation of procedures and institutional arrangements for all aspects of financial administration; (b) having in place the requisite human resource for developing, implementing and maintaining the financial information system; and (c) having in place the necessary legal framework to support these reforms. If it worked, Ghana would have arrived at a computer-age, integrated system of revenue, expenditure, budgeting and implementation, accounting, auditing, cash management and aid/debt management. It should provide an up-to-date

and more accurate information on how much money government is collecting, how much it is spending, where and for what purpose, and what its future obligations are likely to be.¹ And all that should enhance efficiency, accountability, transparency, and predictability of fiscal operations. The arrival of oil in 2011 only added more urgency to budgeting and implementation of reforms and makes it more imperative to enhance the effectiveness of budget implementation, and to correct all aspects of PFM weaknesses. Solutions can be found. But much depends on the political will for action. How successful or unsuccessful has Ghana been?

This combined edition of the annual report on the economy of Ghana for 2013-14 is devoted to Public Finance Management. It is about how the policies, legal framework, institutions, processes and mechanisms by which the public resources are managed and accounted for. Persistent fiscal deficits, current account deficits, mounting public debt and the consequent fiscal bottlenecks in the past decade once again bring government's spending and the machinery to account for public resources into a driving role in economic management. The issues raised by the deficits and the debt servicing have gained considerable momentum of late in public conversation as public institutions, especially those in education and health, grapple with shortfalls in the minimum spending required to deliver the desired levels of basic services to the population. The report is in two parts: Part I presents a review of economic performance over the period 2013-2014, and Part II is devoted to public financial management.

With respect to PFM, the report focuses on three main issues: an overview of public finances in the past decade, the evolution of PFM in the past three decades, and finally on the nature of debt management in the near term. With respect to the recent history of public finances, we provide an overview of the sources of Ghana's persistent fiscal deficits. We turn next to the legislative, administrative and institutional measures introduced over the years to strengthen organization and management structures and processes. This will draw us into specific initiatives and the challenges that may have led to the less than desirable outcomes of the various reforms, and finally to the sustainability of the growing public debt. The report highlights the role of the Legislature and Auditor General in PFM and concludes by drawing lessons from the experiences of other countries to provide key recommendations for ensuring the success of the next generation of PFM reforms.

The report is organized as follows.

¹ *Towards a New Public Service for Ghana: A Working Document*, Public Sector Reform Secretariat, Office of the Senior Minister, 2004

PART I: Review of Economic Performance

Chapter 2 provides a background to Ghana's economic performance over 2013-2014 and observes that overall performance judging by output growth alone remained positive but weak due in part to the slump in commodity prices and the adverse effects of energy shortages. Average annual growth rate fell from 7.9 percent in 2012 to 7.6 percent in 2013 and sharply down to 4 percent in 2014. The service and industry sectors have borne the brunt of the productivity loss caused by the energy shortages with the result that growth in 2014 and 2015 is expected to be driven more by agriculture than by service and industry. Job losses are on the rise in both the service and industry sectors largely because of the energy crisis. Moreover, the economy remains heavily dependent on primary commodity exports and therefore vulnerable to unfavourable price swings. The prices of Ghana's major exports, gold and crude oil, declined in 2014. Export revenues have fallen and have contributed to the depreciation pressures on the cedi.

Chapter 3 briefly reviews recent fiscal performance. Despite assurances of fiscal prudence, tax revenue fell short of spending requirements, fiscal deficits exceeded targets in both years and public debt rose sharply from 47.3 percent of GDP in 2012 to 54.6 percent in 2013 then to 67.1 percent by the close of 2014. The key monetary and financial developments in 2013 and 2014 are reviewed in Chapter 4. Monetary aggregates grew moderately in 2013 but accelerated in 2014. Inflation accelerated in 2013 and 2014 due largely to demand pressures from expansionary fiscal policies, cost-push effects of hikes in fuel and utility prices, and from exchange rate depreciation. Bank of Ghana hiked its Policy Rate in 2013 and 2014 in response to rising inflation and pressures on the exchange rate. This led to increases in other interest rates, further worsening the cost of borrowing and was a deterrent to investment and private sector-led job growth.

Chapter 5 reviews the trends in Ghana's international trade and the balance of payment developments. Generally, Ghana's foreign trade in goods between the European Union remains the largest, followed by trade with the Far East led by the India and China markets. South Africa, United Arab Emirates and other non-European markets remain important trade corridors as well. In 2012 and 2013, Ghana recorded successive double digit current account deficits, averaging 11.8 percent of GDP. There was modest improvement to a deficit of 9.2 percent in 2014 largely because of a decrease in non-oil imports by 22.4 percent compared to 5.6 percent drop in exports. Ghana's capital and financial account in 2014 saw net inflows equivalent of 8.4% of GDP, lower than net inflows of 11.0 percent of GDP in 2013 and 8.8% in 2012.

PART II: Public Financial Management

Innovations in Public Finance Management

Chapter 6 introduces the overall challenges facing Ghana's PFM and the innovations towards improving the system. We trace the generation of policy reforms from the World Bank's Structural Adjustment Program and Economic Recovery Programs of the mid-1980s to the current Ghana Integrated Financial Management Systems, and conclude that progress has been uneven. ***There has been a relatively greater measure of success in financial legislation, revenue mobilization and management, but less in budget reforms –planning, design, implementation and evaluation - and expenditure control.*** Systemic weaknesses remain in the budgetary process and they continue to undermine legislative measures intended to improve overall PFM. Success in PFM calls for a better coordinated effort in planning, designing, implementing and monitoring.

Three Decades of Fiscal Performance

Chapter 7 focuses on the nature of Ghana's fiscal performance over the last decade and observes that Ghana's electoral spending cycles have led to the emergence of large fiscal imbalances putting at risk the prospects of growth and improvements in standard of living anticipated at the onset of oil production in 2011. High fiscal expansion has led to high levels of public debt and monetary growth. Ever since the Gross Domestic Product (GDP) was rebased, revenue as a share of GDP has fallen behind the sub-regional average at a time when growth in public spending has outstripped growth in revenues. ***Expenditure overruns across ministries, department and agencies have been rampant in recent years. They signal weak expenditure control systems and undermine budget credibility.*** A rigid budgetary system which commits about 60 percent of domestic tax revenues to the payment of statutory funds, wages and salaries coupled with high debt service cost underlie the high and inflexible spending, leaving little to no room for active expenditure management. The systemic and structural issues of PFM should focus on innovations in planning, budgeting, transparency and accountability to ensure that resources that become available are not wasted or lost through corruption.

The Debt Service Problem

Although cyclical fiscal deficits may spur growth, persistence deficits are harmful to growth. Because inevitably they increase debt levels, raise debt service challenges, and often induce monetary expansion, which together with borrowing put upward pressure on interest rates. Chapter 8 addresses these debt issues. After reducing her stock of external debt under the Highly Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiative (MDRI) mechanisms, Ghana in recent years has developed an insatiable appetite for borrowing. The drying up of traditional borrowing sources and the resort to commercial borrowing have raised sustainability questions. ***Ghana does not only have a high level of public debt above the critical 60 percent mark, its debt***

burden in terms of interest payments is also beyond recommended thresholds for emerging economies. Ghana's fiscal sustainability is under threat on account of its debt service to domestic revenue ratio. To be sustainable, there are several options open to government. Apart from debt restructuring and growing the economy, government must examine its institutional arrangements in debt management. Enacting debt management and fiscal responsibility laws and establishing an independent debt management office are options that are expanded in Chapter 9.

Are Fiscal Policy Rules the Answer?

Chapter 9 investigates whether the adoption of fiscal policy rules and independent fiscal policy councils can help improve fiscal performance in Ghana, and concludes that fiscal rules, particularly budget balance and debt rules are strongly associated with a higher probability of reducing the public debt to GDP ratio. In addition, fiscal rules do not operate in isolation and require supporting institutions and reforms to deliver the anticipated outcome. *Key reforms to make fiscal rules effective in Ghana include strengthening budget preparation, apportionment and execution; establishing an independent fiscal policy council to provide independent assessment of macroeconomic and revenue forecasts; monitoring and enforcement procedures, and legislative changes to make fiscal rule legally binding.*

The Role of Parliament and the Auditor General in PFM

Chapter 10 turns to the role of Parliament and the Auditor General in ensuring effective PFM. Despite their clear constitutional mandates, these institutions have been largely ineffective in their various mandates partly because of their lack of capacity and partly because of excessive executive control in the management of public finances. Ghana's experience shows that *the mere existence of a formalized process of parliamentary scrutiny of public finances does not guarantee efficient and accountable use of public resources.* Series of Auditor General Reports highlight non-compliance with internal control of public spending across state institutions, misappropriation, and in some cases outright embezzlement of public funds. Parliament must engage more effectively by strengthening its role in the PFM system. The task begins with budget scrutiny and approval and ends with the Public Account Committee's (PAC) scrutiny of the use of these resources. The PAC requires quality and timely reports from the Auditor General to do its work. The Auditor General in turn requires the PAC to critically scrutinize its reports and sanction appropriately to ensure that audit outcomes are meaningful and are addressed by all public institutions. The lack of adherence to the rules and processes of public financial administration and the consistent failure to implement recommendations following parliamentary scrutiny of public accounts undermine all standards of prudent fiscal policy management.

Future of PFM

Building on the preceding discussions, the final chapter highlights the challenges that have limited the success of PFM reforms in Ghana, draws on the experiences of other countries to provide recommendations for ensuring the success of the next generation of PFM reforms. While the concluding observations and recommendations do not pass off as a comprehensive list of all best practices, they do provide a synthesized view of what has worked for implementing successful reforms in other countries.

1. Reforms must be part of an overarching strategy, spelling out how and what of reform. In other words the strategy must spell out the process of reform, the instruments of reform, the roles and responsibilities of all central agents of reform, and must also spell out what needs to be changed and to what end.
2. Reforms also require commitment at the highest political and administrative level. In Ghana the Minister of Finance is the final authority for releases of large value. Without a committed Minister, fiscal rules may be set aside for political expediency, undermining the reform process.
3. Reform should be embedded in the Central Finance Agencies; namely, the Ministry of Finance and the Controller & Accountant General's Department with an emphasis on capacity building, through training, restructuring, and computerization. Setting up enclave secretariats as in the case of the BPEMS limits effectiveness especially if the secretariat officials are not civil servants. Oversight functions are generally weaker in the hands of a semi-autonomous secretariat, especially if the head of the secretariat still needs to defer to the civil service directors for decision making.
4. The PFM reform work should be linked to a monitoring and evaluation framework that evaluates progress periodically and incorporates lessons learnt in order to improve the ongoing reforms.
5. Reforms must be country led with donor financial and technical support provided to support the vision of the reform.
6. Coordination and cooperation in PFM reform is also vital for success. Success requires stakeholders of all the Central Finance Agencies and Parliament to be fully aware of the different aspects of the reform that are being implemented by the various institutions; if only to reduce duplication in reform efforts, reducing waste and fostering value for money.

2. GHANA'S ECONOMIC PERFORMANCE AND REST OF THE WORLD

Small open economies like Ghana are susceptible to developments in world markets and are linked, to some extent, to the fortunes of other economies particularly those of its trading and development partners. This chapter presents an overview of economic performance in Ghana for the period 2013-2014, reviews trends in the world economy during 2013 and 2014, and highlights the implications of these trends for the Ghanaian economy.

2.1 Economic Performance in Ghana 2013-2014

Ghana's economic performance over 2013-2014 continued to remain positive even if weaker than expected. Annual average growth rate fell from 7.9 percent in 2012 to 7.6 percent in 2013 but dropped sharply to 4 percent in 2014. Growth was driven largely by the services sector which on average sustained a growth of about 10 percent per annum from 2011 to 2013. The highest growing sector in 2013 was the services sector at 9.1 percent, with industry and agriculture growing at 9.1 percent and 3.4 percent respectively. However, the agriculture sector is projected to be the highest growing sector in 2014, expanding by 5.3 percent compared to 4.6 percent growth for both industry and services.

Performance in the agriculture sector in 2014 was driven mainly by a rebound in forestry and logging which recorded a growth of 16.5 percent compared to a negative growth of 0.04 percent in 2013. Industrial sector growth is expected to be adversely affected by a weak performance in the mining and quarrying, electricity and manufacturing sub-sectors. Growth in the services sector in 2014 was much lower than in previous years mainly due to negative growth in the health and social services sector (-7.0 percent), business, real estate and others (-2.7 percent) and trade, repair of vehicles, household goods (-1.5 percent). The recent energy crisis has contributed immeasurably to decline in industry and somewhat to the weakening performance of the service sector.

Trade and Balance of Payments

The value of merchandise exports in 2013 increased marginally by 0.9% from the value recorded in 2012. The increase was largely driven by increased earnings from the export of oil, timber and non-traditional exports which more than offset a decline in earnings from the export of cocoa and gold. The recorded value of merchandise exports decreased by 2.8 percent in 2014 largely on account of a decline in gold and crude oil prices on the world market as well as a reduction in the volume of crude oil exports. The value of gold exports declined from \$3,708.9 million in 2013 to \$3,369.3 million in 2014 due to the fall in gold prices on the international market. Although the volume of gold exports increased by 3.4 percent, a 12.1 percent decline in the average realized price of gold eroded any gains from the increase in volume of gold exports. The value of crude oil exports also fell by 1.7 percent in 2014, compared to its value in 2013 due to a

fall in the volume of barrels exported from 27.6 million barrels in 2013 to 27.3 million barrels in 2014 and a decrease of 0.6 percent in the realized price for crude oil exports.

With regards to imports, the value of merchandise imports declined by 17.8 percent in 2014 compared to a fall in imports of 1.8 percent in 2013. The continued decline in the value of imports was driven by a continued fall in the value of non-oil imports. Although oil imports increased by 1.0 percent in 2013 and by 2.2 percent in 2014, the value of non-oil imports declined by 1.8 percent in 2013 and experienced an even greater decline of 22.8 percent in 2014.

Inflation and Exchange Rates

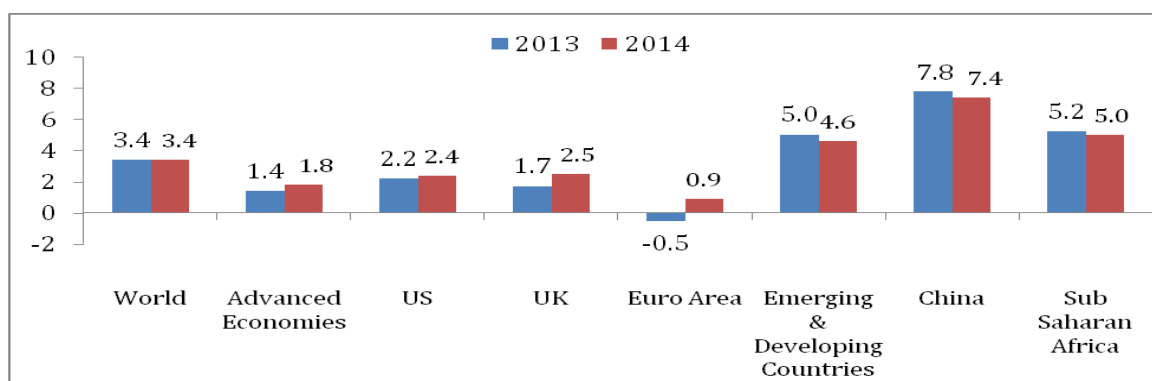
The Ghanaian economy experienced strong inflationary pressures during the review period. Inflation increased from 8.8 percent in December 2012 to 13.5 percent in December 2013 and to 17.0 percent in December 2014. Inflation pressures are attributed to the cedi depreciation, effects of petroleum and utility price adjustments as well as persistent and large fiscal deficits.

In 2013, the Ghana cedi depreciated by 4.12 percent, 16.73 percent, and 20.1 percent against the US dollar, the pound sterling and euro respectively. In the first nine months of 2014, the depreciation of the cedi continued with a record depreciation of 31.2 percent against the US dollar, 29.3 percent against the pound sterling, 23.6 percent against the euro. The depreciation of the cedi was influenced by reduced export earnings as the price of exports, particularly gold fell during the review period.

2.2 Global Trends in Growth and Trade

Changing dynamics to world output emerged in 2013, with a number of advanced economies rebounding from the recession while growth in emerging economies slowed down. Advanced economies grew by 1.4 percent in 2013 and by 1.8 percent in 2014, compared to 1.2 percent in 2012, while growth in emerging markets and developing economies fell from 5.0 percent in 2012 to 4.7 percent in 2013 and to 4.6 percent in 2014. Lingering challenges from the global financial crises such as debt overhangs and unemployment kept overall global output growth at a level of 3.4 percent in both 2013 and 2014.

Figure 2.1 Economic Growth (2013-2014) Percent



Source: World Economic Outlook, April 2015

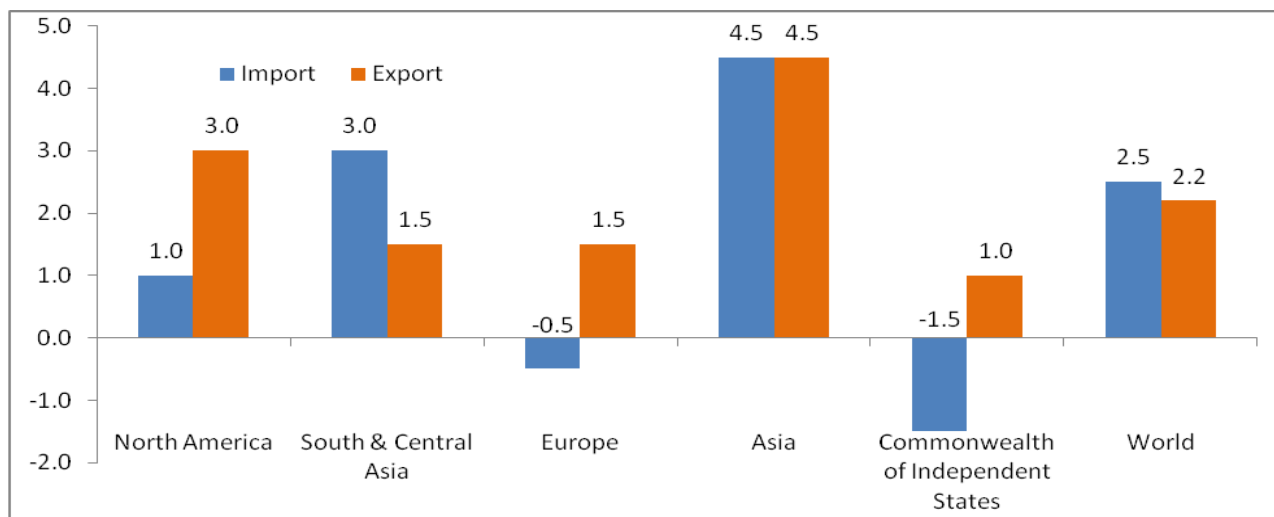
Among advanced economies, the United States and the United Kingdom appear to be leaving the crises behind with slight improvements in positive growth rates. The United States' output expanded by 2.4 percent in 2014 compared to 2.2 percent in 2013 and 2.2 percent in 2012. According to the World Economic Outlook Report (April 2015), domestic demand in the United States was boosted by lower oil prices, moderate fiscal adjustments and more accommodative monetary policies. Output in the United Kingdom increased by 2.5 percent in 2014, up from the 1.7 percent growth in 2013 and 0.3 percent growth in 2012. Growth in the United Kingdom in 2014 was supported by falling oil prices and improved financial market conditions.

Japan's economy recovered somewhat in 2013 and 2012, with a 1.6 percent growth rate in 2013 and 1.5 percent growth in 2012, spurred on by Prime Minister Shinzo Abe's policies of increased government spending and monetary easing or Abenomics as the Prime Minister's set of policies became known. The recovery was however dampened in 2014 as the country recorded an output growth of -0.1 percent largely because of weak domestic consumption and residential investment.

Recovery in the euro zone remained slow in 2014, with an output growth of 0.9 percent. While this is an improvement over the 0.5 percent decline in growth achieved in 2013, the region's recovery was hampered by the legacies of the financial crises especially for the periphery southern European economies (Portugal, Italy, Greece and Spain).

Among emerging market economies, China sustained high growth though lower than in previous years with a rate of growth of 7.8 percent in 2013 and 7.4 percent in 2014 compared to 7.7 percent in 2012 and 9.2 percent in 2011. India recovered from a relative slump with a 7.2 percent 2014 growth compared to 6.9 percent in 2013. Russia on the other hand experienced lower growth of 0.6 percent in 2014 compared to 4.2 percent in 2013. The slower growth in Russia was due in part to the crisis in Ukraine and partly to uncertainty regarding investments.

World merchandise trade grew by 2.2 percent in 2013 marginally lower than the 2.3 percent growth achieved in 2012, and much lower than the average 5.3 percent over the decade 1993-2013 and 6 percent achieved in the 20 years prior to the 2008-09 financial crisis. The after effects of the financial crises in Europe, high unemployment in many euro area countries, uncertainty about the timing of the end to the US monetary stimulus, and the politics regarding US debt levels have all contributed to the sluggish growth of world trade.

Figure 2. 2 Growth in Merchandise Trade 2013

Source: *International Trade Statistics 2014*

2.3 Developments in Major Advanced Economies – Growth and Fiscal Balances

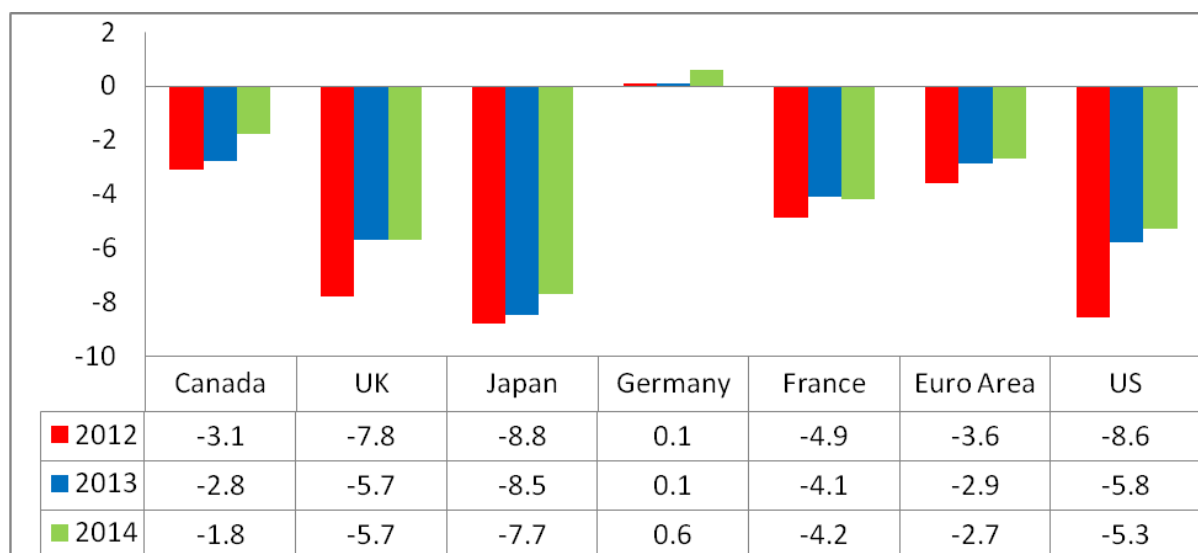
During 2013, economic activity in major western countries picked up from their rather low levels in the previous few years. Growth in the United States continued at a modest pace supported by a rebound in the housing market, accommodative monetary policy and higher household net worth although tighter fiscal policies dampened the growth rate. The US unemployment rate continued its downward trend from a high of 19 percent in 2009 to 7.3 percent in August 2013. The US current account deficit continued to shrink through the second quarter of 2013, partly on account of increased domestic energy production and therefore lower US energy imports.

The second quarter of 2013 saw some growth return to the euro zone after 6 quarters of downward trend. However, the effects of the global recession continued to restrain growth in 2013. Domestic demand within the countries of the euro zone was particularly weak as the public and private sectors continue to reduce debt levels rather than increase consumption and investments. In the core economies of the euro zone where some debt level reduction has already been achieved, growth in domestic demand was still muted due to uncertainties about recovery in the euro area. Overall, growth in the euro zone contracted by 0.5 percent in 2013 compared with a contraction of 0.7 percent in 2012. Conditions improved in 2014 with a growth rate of 0.9 percent at the end of the year.

Many major advanced economies continued with fiscal consolidation efforts in 2013 and 2014. As in the previous years since the crises, these consolidation efforts yielded some improvements in public finances. The United States reduced its net borrowing levels from 8.6 percent of GDP in 2012 to 5.8 percent of GDP in 2013 and to 5.3 percent in 2014. While there are lingering challenges in the euro zone, the region reduced net borrowing levels to 2.7 percent of GDP in 2014, down from 2.9 percent of GDP in 2013

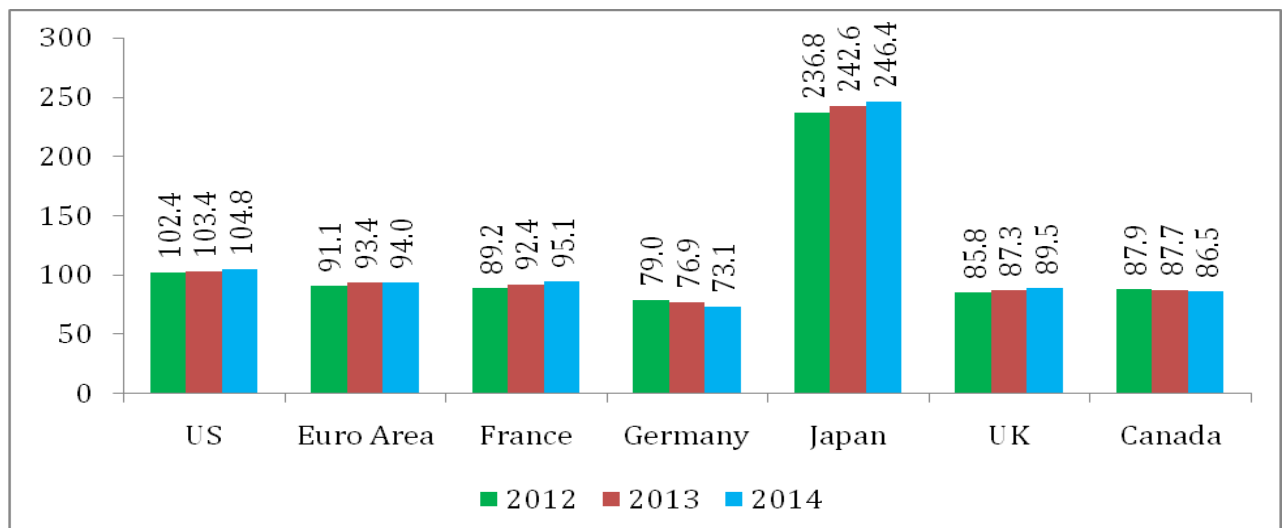
and 3.6 percent of GDP in 2012. Germany in particular continued to record a positive net lending position, increasing from 0.1 percent of GDP in 2013 to 0.6 percent of GDP in 2014. Further improvements in fiscal balances are expected over the medium term. Among advanced economies, Japan continues to register one of the highest fiscal deficits, but these are expected to continue to steadily decline over the medium term as the country's recovery continues.

Figure 2.3 Net Lending and Borrowing



Source: World Economic Outlook, April 2015

Gross Government debt although falling in some instances remains high in a number of advanced economies. Japan in particular saw an increase in the gross debt levels from 237.3 percent of GDP in 2012 to 246.4 percent of GDP in 2014. Gross debt levels also increased for the United States, the Euro Area, France, and the United Kingdom. Among major advanced economies, Germany stood out in reducing its gross debt levels from 79.0 percent of GDP in 2012 to 76.9 percent in 2013 and to 73.1 percent of GDP in 2014.

Figure 2.4 General Government Gross Debt (percent of GDP)

Source: World Economic Outlook October April, 2015

2.4 Trends in Major Commodity Prices – Crude Oil, Cocoa, and Gold

Strong demand during the first quarter of 2013 contributed to increasing crude oil prices to a high of \$116.05 per barrel for Brent crude oil in February 2013. The price dropped to reach an average of \$103.4 per barrel in the second quarter of 2013 largely on account of lower demand from China and increased supply from the United States. The price picked up again in the third quarter of 2013 on the back of increased demand from US and China, expectations of a reduced output from the North Sea, increased tensions in South Sudan and supply outages in the US and France to end the year at \$110.76 per barrel.

In 2014, crude oil prices trended sharply downwards from \$108.12 in January to \$62.34 by December 2014. A variety of factors contributed to the fall in prices including, but not limited to, weaker than expected global activity and with it a weaker demand for oil coupled with improvements in energy efficiency. On the supply side, a steady increase in production by countries not belonging to the Organisation of Petroleum Exporting Countries (OPEC), particularly the United States, coupled with the decision by OPEC in November 2014 to maintain production levels contributed to the precipitous decline in prices.

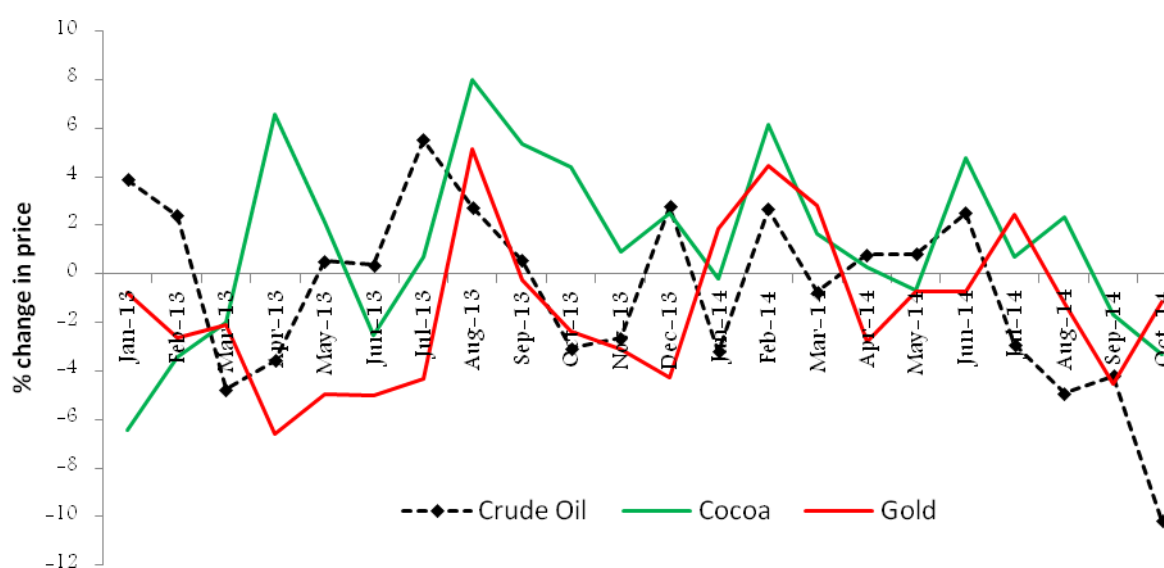
Gold price declined from \$1,665.4 at the beginning of the 2013 to reach \$1,314.7 per fine ounce in July 2013 driven by improvements in the equities market, the announcement of Cyprus Gold's bailout in April, the dumping of gold Exchange Traded Fund by investors and India's import restriction. Prices dropped further in the last quarter of 2013 to \$1,223 per fine ounce. Prices in 2014 remained flat with small upward and downward swings from month to month and by October 2014, the price of gold was around \$1,222.49 per fine ounce.

Cocoa prices initially declined in the first two months of 2013 due to favourable supply conditions in West Africa and decline in European demand. The price of cocoa however

rose steadily to end the year at \$2,439.09 per metric tonne up from \$2,377.07 recorded at the end of 2012. Cocoa prices in 2014 continued to trend upwards reaching \$3,171.47 per metric tonne at the end of 2014.

The Ghanaian economy is heavily dependent on the export of cocoa and gold and the unfavourable price swings for these two commodities has had adverse effects on export revenues in general and foreign exchange revenues in particular contributing to the depreciation of the cedi by 4.1 percent against the US dollar in 2013 and by 31.2 percent against the US dollar in the first nine months of 2014. Falling crude oil prices have further exacerbated the problem of exchange reserves and contributed to the unpredictability of budget revenues as actual realised prices fell short of the benchmark price of \$93.3 for revenue projections.

Figure 2.5 Commodity Prices (December 2010 = 100)



Source: World Bank Global Economic Monitor (GEM) Commodities

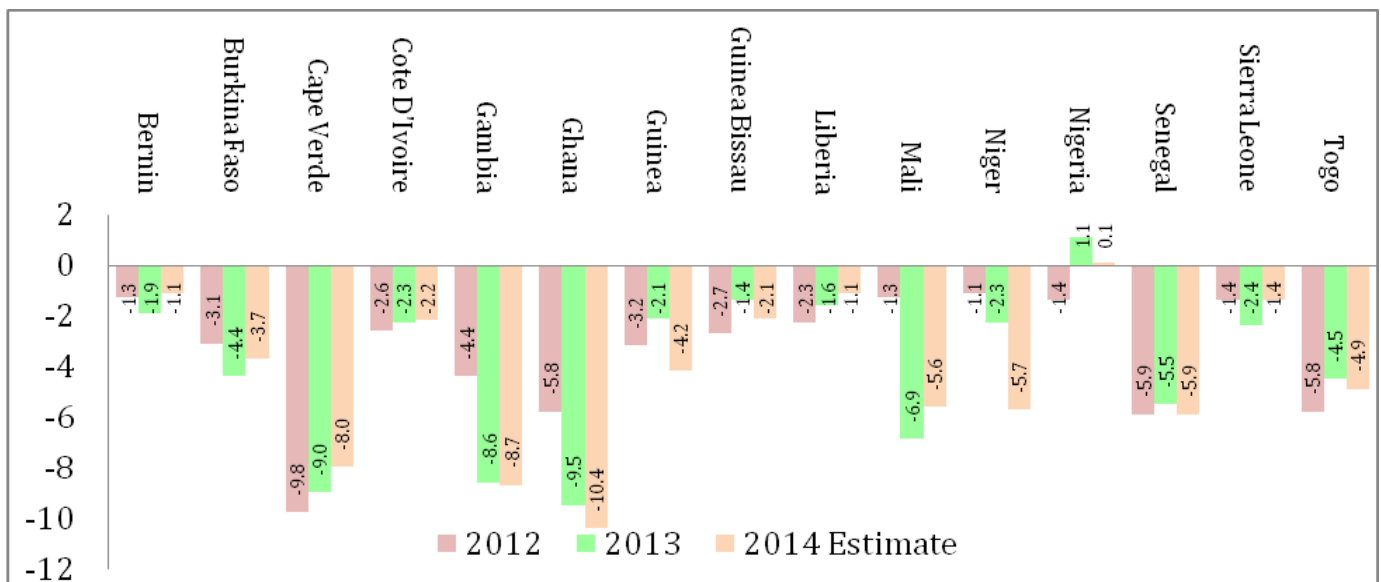
2.5 Developments in West Africa

In 2013, the West African sub region continued to enjoy the effects of the natural resource boom, registering the highest regional growth rate in Africa of 7 percent, higher than East Africa's 6 percent, Central Africa's 4 percent, Southern Africa's 3 percent and North Africa's 1.9 percent. Growth in West African countries was individually robust with most countries achieving a growth rate of 6 percent or more. Notably, Sierra Leone was the region's fastest growing economy with a growth rate of 16.3 percent in 2013 largely supported by iron ore exports. Liberia recorded a growth rate of 8.1 percent largely driven by increased iron ore exports and expansion in construction and services. The Nigerian economy, the region's biggest, expanded by 5.5 percent on the back of increased output in manufacturing and entertainment. Nigerian non-oil GDP growth was higher at 8.4 percent but a decline in oil and gas of -13.1 percent brought down overall GDP growth levels.

Other macroeconomic indicators showed broad improvements with varying challenges for individual countries. Average inflation fell from 9.9 percent in 2012 to 7.5 percent in 2013 and average overall fiscal deficit is projected at -1.8 percent in 2014 down from -2.2 percent in 2013. Many countries continued to implement fiscal tightening in order to reduce budget deficits but challenges to fiscal consolidation still remain a widespread problem.

The Ebola outbreak in the West African sub region took a toll on labour markets and created substantial health and containment costs for the countries affected. The countries at the centre of the outbreak – Liberia, Guinea and Sierra Leone experienced not only extensive human suffering and a large number of deaths but also an economic slowdown and a strain on public finances. Economic activity suffered from risk aversion behaviours by international and domestic agents. Notably, there was reduced capital utilisation due to mine closures, reduced trade from border closures and government quarantine activity, and an increase in risk of food insecurity due to a drop in domestic food production coupled with food import restrictions related to border closures.

Figure 2.6 Overall Fiscal Balance, including Grants (percent of GDP)



Source: African Economic Outlook 2014 and 2015

The African Economic Outlook for 2015 reports that the output loss in the three countries in 2014 amounted to \$1.4 billion in purchasing power parity. Future output losses in the three countries are expected to be large and the IMF has revised its earlier growth projection of an average of 6.5 percent over 2014-15 and expects that output will contract in 2015 in the three countries (Regional Economic Outlook, 2015). While the effects of the virus have been contained from spreading to neighbouring countries, the region has experienced lower cross border trade and reduced international tourism.

2.6 Medium Term Implications for Ghana

Developments in the world economy in 2013 and 2014 have varied implications for the Ghanaian economy over the medium term. The following are notable expected impacts on the economy:

Depreciation of the Cedi: The continued demand pressures on the cedi may likely be exacerbated by further foreign exchange shortages as a result of falling commodity prices, decline in export demand, reduction in aid flows and remittances. While these problems are individually significant, their combined effects on the supply of foreign exchange is particularly worrying given how much the cedi depreciated against the major currencies in 2013 and 2014. Continuing depreciation may spark speculative demand as investors seek to protect the external value of their domestic investments, especially for those who must generate cedis equivalent to service external debt obligations. For public finance, it also means adverse fiscal effects because of debt servicing.

Low Export Demand: Many of the major advanced economies are yet fully recovered from the financial crises of 2008. While the evidence from 2013 and 2014 show that there is consistent positive growth being recorded in countries like the United States, the United Kingdom and Germany, legacies of the crises remain a challenge to growth. For emerging market economies, growth over the past two years has been slower than in preceding years. Most notably, growth in China appears to be stabilising at a level lower than what was attained in the past decade. With sluggish growth in major advanced economies and slower growth in emerging market economies, demand for Ghana's exports may likely be muted over the medium term. This is already reflected in declining prices for Ghana's traditional exports and may affect the prospects of increased growth of non-traditional exports which may have been able to counter the effects of declining export revenue from traditional sources.

Aid Flows: A number of development partners notably traditional western donors continue to grapple with their own fiscal consolidation efforts in their home countries. Possibly on account of this, current aid projections from the latest survey on donors' forward spending plans by the OECD indicate some stagnation in Overseas Development Assistance (ODA) flows to African countries. The impact of this problem on Ghana may however be muted by the possibilities of accessing non-concessional lending from non-traditional development partners like China and other emerging market economies. While this other form of borrowing will be more expensive, directing it on high yielding investments will ease the associated costs and allow for a substitution for declining ODA.

Remittances: Remittance flows have steadily increased over the past decade and have proven to be resilient against the 2008 financial crisis and its aftermath. With the return of positive and consistent growth to major advanced economies, the outlook for

remittance flows remains positive. The US unemployment rate continues to trend downwards and recovery in the United Kingdom is projected to continue over the medium term. Remittance inflows to Ghana will likely remain strong over the medium term.

Foreign Direct Investments: The stable and consistent growth occurring in some key western economies that are traditionally sources of FDI to Ghana provides a stable and positive outlook for FDI inflows over the medium term.

3. FISCAL DEVELOPMENTS IN 2013-2014

Fiscal policy in 2013 and 2014 had similar objectives: ensure fiscal prudence and debt sustainability. Against the background of a high deficit of 11.6 percent in election year 2012, fiscal policy aimed to reduce the deficit in 2013 and 2014. The deficit targets of 9.0 percent was set for 2013 and 8.5 percent (revised upwards to 8.8 percent in a mid-year budget review) for 2014. Measures intended to achieve the fiscal objectives included:

- Improve revenue mobilization.
- Rationalize and enhance efficiency of public expenditures, and
- Review capital expenditure and financing methods.

The major fiscal developments in 2013 are:

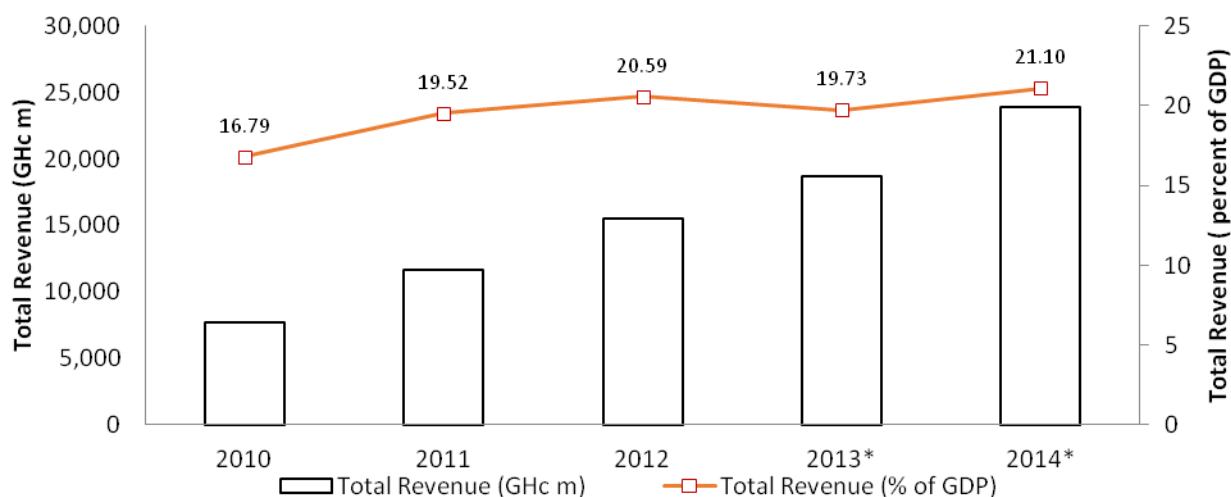
- Domestic revenue increased by GH¢3,224 million (20.8 percent above the 2012 collection) to GH¢18,732 million. The tax effort however fell marginally from 20.6 percent of GDP in 2012 to 19.7 percent in 2013.
- Expenditure increased by GH¢6,518 million to GH¢27,463 million (or 28.9 percent of GDP).
- The (cash) budget deficit was GH¢10,344 million (or 10.9 percent of GDP), higher than the budget target of 9.0%.
- Public debt increased from 47.3 percent of GDP in 2012 to 54.6 percent of GDP in 2013.

And for 2014:

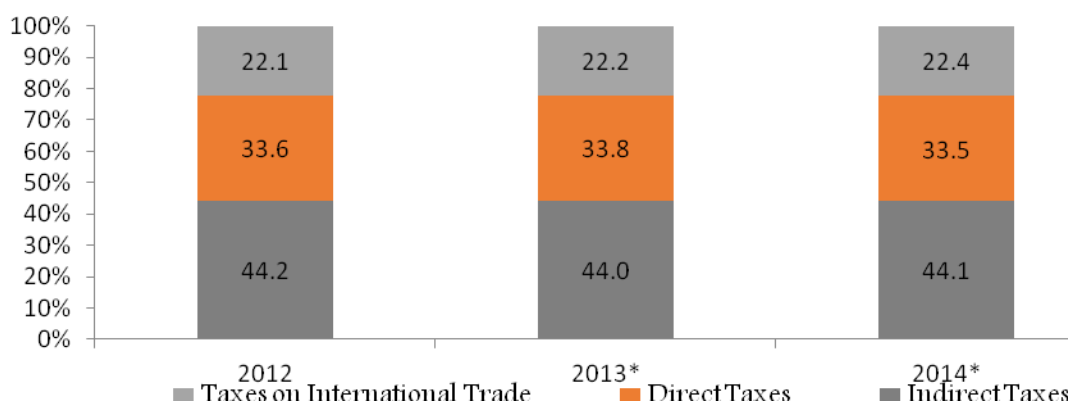
- Domestic revenue increased by GH¢ 5,199 million to GH¢23,937 million (or 21.1 percent of GDP).
- Expenditure increased by GH¢4,499 million to GH¢31,962.2 million (or 28.2 percent of GDP).
- The (cash) budget deficit was GH¢10,539.6million (or 9.3 percent of GDP), higher than the budget target of 8.8%.
- Total public debt increased from 54.6 percent of GDP in 2013 to 67.1 percent of GDP in 2014.

3.1 Government Revenue

In 2013, domestic revenue increased by GH¢3,224 million over the 2012 figure to GH¢18,732 million (or 19.73 percent of GDP). The tax component of domestic revenue increased by GH¢1,790 million over the 2012 figure to GH¢14,308 million (or 15.1 percent of GDP and 76.4 percent of the total domestic revenue). Of the tax collection in 2013, direct taxes amounted to GH¢6,302 million (or 44 percent of the total); indirect taxes, comprising value-added tax, taxes on domestic goods and services and NHIS Insurance Levy, amounted to GH¢4,833million (or 33.8 percent of the total); and international trade taxes amounted to GH¢3,173 million (or 22 percent of the total, Figure 3.1 and Figure 3.2)

Figure 3.1 Domestic Revenue (GH¢, millions)

Domestic revenue in 2014 increased by GH¢5,199 million over the 2013 figure to GH¢23,931 million (or 21.1 percent of GDP). The tax component of domestic revenue increased by GH¢4,922 million to GH¢19,229.8 million (or 17 percent of GDP). Of the tax collection in 2014, direct taxes amounted to GH¢8,487 (or 44.1 percent of the total); indirect taxes amounted to GH¢6,434 million (or 33.5 percent of the total); and international trade taxes amounted to GH¢4,309 million (or 22.4 percent of the total).

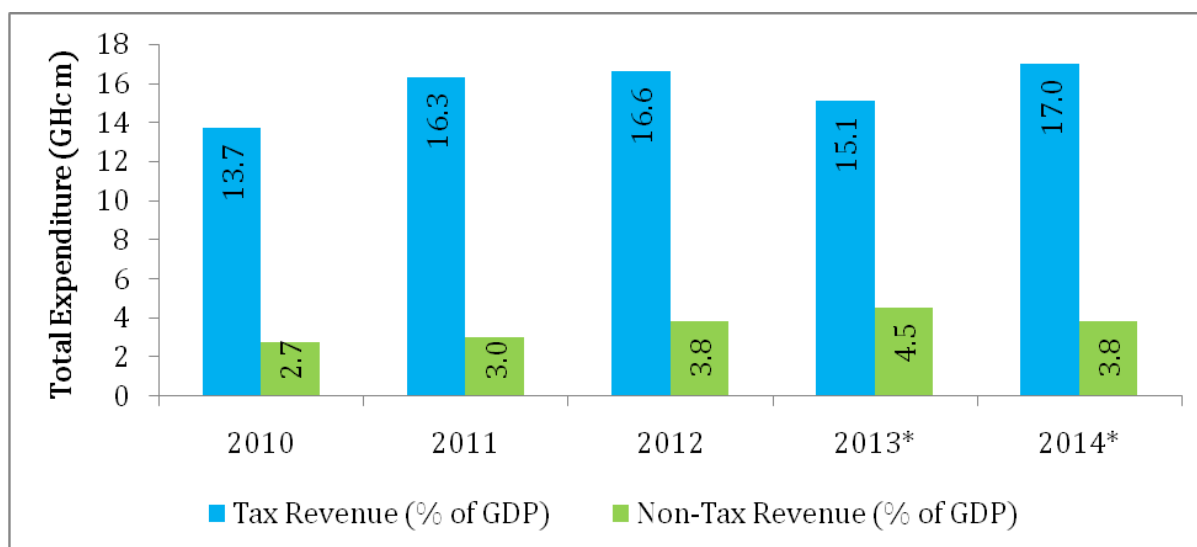
Figure 3.2 Composition of Tax Revenue (Percent)

While Ghana's tax-to-GDP ratio increased from 15.1 percent in 2013 to 17 percent in 2014, it is still low by international standards. The low tax collection is the result of the narrow tax base, high rate of evasion, high level of exemptions, high level of fraud/corruption and administrative lapses, which need to be addressed.

Table 3.1 Domestic Revenue (Percent of GDP)

Indicators	2010	2011	2012	2013*	2014*
Total Revenue	16.79	19.52	20.59	19.73	21.10
Tax Revenue	13.67	16.34	16.62	15.07	16.95
Direct Tax	5.33	6.75	7.35	6.64	7.48
Income Tax	2.42	2.50	3.14	2.68	2.84
<i>Personal</i>	2.20	2.28	2.93	2.49	2.64
<i>Self Employed</i>	0.22	0.22	0.22	0.19	0.19
Companies	2.15	2.62	3.14	2.44	2.67
Company Taxes on Oil	0.00	0.00	0.00	0.44	0.70
Others	0.76	1.63	1.07	1.07	1.27
<i>Others direct Taxes</i>	0.48	1.33	0.95	0.93	1.08
<i>Airport Tax</i>	0.08	0.08	0.09	0.09	0.05
Indirect Tax	5.47	6.13	5.59	5.09	5.67
Value Added Tax	3.51	3.97	3.69	3.49	4.12
<i>Domestic Tax</i>	1.41	1.65	1.41	1.40	1.69
<i>External</i>	2.11	2.32	2.28	2.09	2.43
Taxes On Domestic Goods	0.81	1.01	0.97	0.73	0.67
<i>Excise Duty</i>	0.26	0.28	0.25	0.18	0.13
<i>Petroleum Tax</i>	0.56	0.73	0.72	0.55	0.54
National Health Insurance Levy	0.84	0.92	0.76	0.68	0.69
Other Revenue	0.30	0.23	0.17	0.18	0.19
Taxes on International Trade	2.49	2.53	3.68	3.34	3.80
Imports (Import duty)	2.28	2.53	2.51	2.35	2.44
Exports (Export Cocoa)	0.21	0.01	0.14	0.11	0.28
Non-Tax Revenue	2.66	3.05	3.79	4.49	3.78

Source: Author's Computation

Figure 3.3 Components of Total Revenue (percent of GDP)

In 2013, non-tax revenue increased by GH¢1,413 million over the 2012 figure to GH¢4,265 million. This was 4.5 percent of GDP and 22.8 percent of total domestic revenue (Table 3.1).

In 2014, non-tax revenue increased by only GH¢23.8 million over the 2013 level of GH¢4,289 million, representing 3.8 percent of GDP or 17.9 percent of total domestic revenue. (Table 3.1) In 2013, grants declined by GH¢421 million over the 2012 figure to GH¢739 million. In 2014, grants showed a slight turnaround, increasing by GH¢63 million to GH¢802 million. Over the two-year period as a whole, grants declined by GH¢ 358 million. Ghana's access to concessional resources is expected to decline following its attainment of middle-income and oil-producer status since 2010. Ghana therefore has to explore alternative means of financing its budget, including internally-generated resources and strong emerging market economies, especially Brazil, Russia, China and India (the BRICS) (Table 3.2)

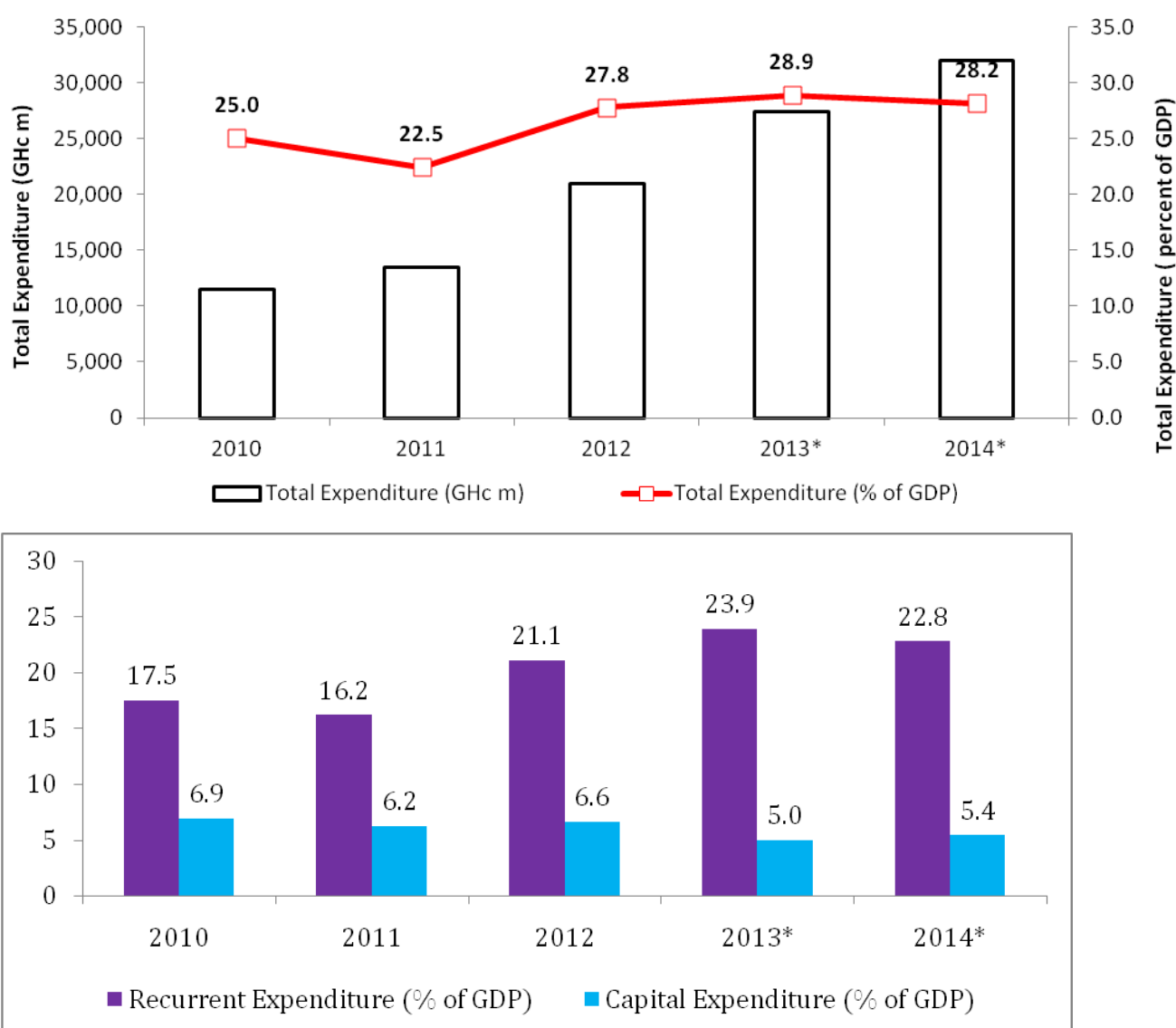
Table 3.2 Grant (GH¢, million)

Indicators	2012	2013 Prov. Outturn	2014 Prov. Outturn	2012/2013 Absolute Change	2012/2013 percentage Change	2013/2014 Absolute Change	2013/2014 percentage Change
GRANTS	1,160.3	739.4	802.1	-420.9	-36.3	62.7	8.5
Percent of GDP	1.54	0.78	0.71				
Percent of Revenue	7.0	3.8	3.2				
Project Grants	512.3	374.0	775.3	-138.3	-27.0	401.3	107.3
Programme Grants	502.5	158.1	26.8	-344.4	-68.5	-131.3	-83.0
HIPC Assistance (multilaterals)	56.7	135.2		78.5	138.4		
Multilateral Debt Relief Initiative (MDRI)	88.8	72.2		-16.7	-18.8		

3.2 Government Expenditure

In 2013, government expenditure increased by GH¢6,518 million over the 2012 figure to GH¢27,463 million (or 28.9 percent of GDP). Recurrent expenditure exclusively accounted for the increase when it rose by GH¢6,698 million to GH¢22,672 million (or 23.9 percent of GDP). This increase resulted from increases of GH¢1,577 million in personal emoluments, GH¢1,961 million in interest payments and GH¢1,229 million in transfers. However, capital expenditure decreased by GH¢180 million to GH¢4,791 million, which was only 5.0 percent of GDP.

Figure 3.4 Government Expenditure



In 2014, government expenditure increased by GH¢4,499 million over the 2013 figure to GH¢31,962 million (or 28.2 percent of GDP). The recurrent component of expenditure increased by GH¢3,195 million to GH¢25,867 million (or 22.8 percent of GDP). This was the result of increases of GH¢2,684 million in interest payments, GH¢1,206 million in personal emoluments and GH¢835.2 million in transfers.

Capital expenditure increased by GH¢1,305 million to GH¢6,096 million, but it accounted for only 5.4 percent of GDP.

Recurrent expenditure accounts for a commanding share of government expenditure, with capital expenditure accounting for only a small fraction. This situation is not in the interest of long-term development. Expenditure needs to be rebalanced as a matter of urgency, especially by taking measures to rein in personal emoluments, interest payments and transfers and thereby creating room for higher development expenditure.

Table 3.3 Government Expenditure by Economic Classification (percent of GDP)

Indicators	2010	2011	2012	2013*	2014*
Total Expenditure	25.0	22.5	27.8	28.9	28.2
Recurrent	17.5	16.2	21.2	23.9	22.8
Non-interest expenditure	14.3	13.5	18.0	19.2	16.6
Personal emoluments	6.9	7.6	8.9	8.7	8.3
Goods & Services	2.1	1.2	1.8	1.5	1.6
Transfers	4.3	4.2	5.9	6.0	5.8
Interest payments	3.1	2.7	3.2	4.6	6.2
Domestic	2.4	2.2	2.5	4.0	5.4
External	0.7	0.5	0.7	0.6	0.9
Capital Expenditure	6.9	6.2	6.6	5.0	5.4
Domestic Financed	2.5	3.3	3.2	1.9	1.1
Foreign financed	4.4	2.9	3.4	3.1	4.3
<i>Source: Author's Computation from Table **</i>					

3.3 Fiscal Deficit and Financing

In 2013, the (cash) budget deficit was GH¢10,344 million (or 10.9 percent of GDP). This was 1.9 percentage points higher than the budgeted deficit of 9.0%. The deficit was financed largely from domestic resources of GH¢7,058 million, while external resources contributed GH¢3,212 million (Table 3.4).

Figure 3.5 Deficit Financing as Percent of GDP

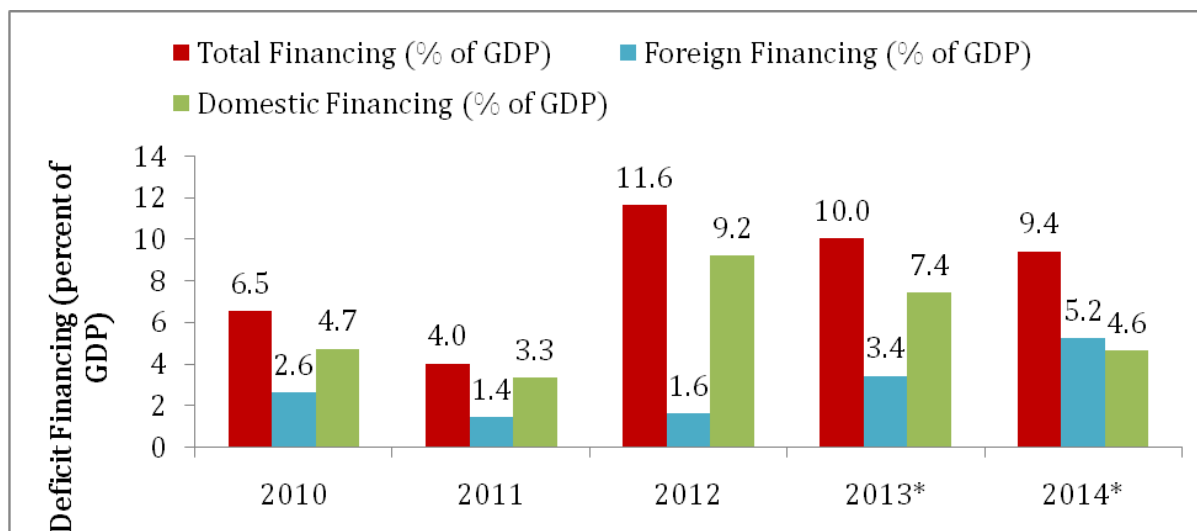


Table 3.4 Deficit Financing (GH¢, millions)

Indicators	2012	2013 Prov. Outturn	2014 Prov. Outturn	2012/2013 Percentage Change	2012/2013 Percentage Change
Overall Balance (Cash)	-7,751.1	-10,344.0	-10,539.6	33.5	1.9
<i>(percent of GDP)</i>	<i>-10.3</i>	<i>-10.9</i>	<i>-9.3</i>		
Overall Balance (Including Divestiture)	-8,715.4	-9,454.6	-10,636.3	8.5	12.5
<i>(percent of GDP)</i>	<i>-11.6</i>	<i>-10.0</i>	<i>-9.4</i>		
Financing	8,715.4	9,454.6	10,636.3	8.5	12.5
Foreign (net)	1,231.4	3,212.0	5,874.1	160.8	82.9
Borrowing	1,855.0	4,033.4	7,205.1	117.4	78.6
Project loans	1,667.4	2,584.5	4,043.2	55.0	56.4
Programme loans	187.6	0.0	0.0	-100.0	
Sovereign Bonds	0.0	1,448.9	3,161.9		118.2
Amortization (due)	-623.6	-821.4	-1,330.9	31.7	62.0
Domestic (net)	6,897.8	7,057.9	5,228.3	2.3	-25.9
Banking	2,463.5	3,610.3	3,017.9	46.6	-16.4
Bank of Ghana	2,196.8	1,166.3	1,581.5	-46.9	35.6
Transfer to Oil Funds	-90.8	-677.7	-1,086.7	646.0	60.3
Comm. Banks	357.6	2,444.0	1,436.4	583.5	-41.2
Non-banks	4,434.3	3,340.3	2,210.4	-24.7	-33.8
Other Financing	542.0	-137.5	-240.3	-125.4	74.7

In 2014, the (cash) budget deficit was GH¢10,540 million (or 9.3 percent of GDP). This was 0.5 percentage points higher than the (revised) budgeted deficit of 8.8%. External resources (GH¢5,874 million) contributed slightly more to the financing of the deficit than domestic resources (GH¢ 5,228 million) (Table 3.4)

3.4 Public Debt

Domestic Debt

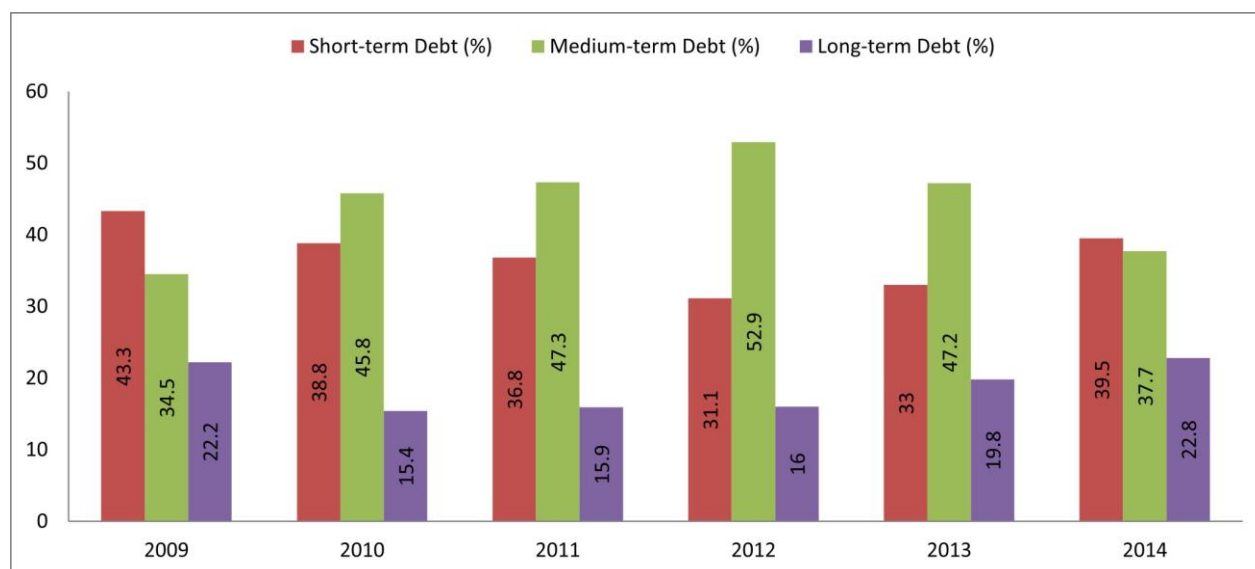
Domestic debt increased in 2013 by GH¢8,235 million (nearly 4.5%) over the 2012 level of GH¢26,666 million. The domestic debt to GDP ratio increased from 24.5 percent to 28.1%. And in terms of the term structure, the short-term (up to 1 year maturity) and long-term (more than 2 years maturity) components increased their shares from 31.1 percent to 33.0 percent and from 16.0 percent to 19.8 percent respectively, while the medium-term component (1-2 years maturity) decreased its share from 52.9 percent to 47.2%. (Table 3.5 and Figure 3.6). In 2014, domestic debt increased by GH¢7,955 million over the 2013 figure to GH¢34,621 million. The domestic debt to GDP ratio increased from 28.1 percent to 30.5%.

Table 3.5 Size and Composition of Domestic Debt

	2009	2010	2011	2012	2013	2014
A. SHORT-TERM	2,643.1	3,214.5	4,353.3	5,734.9	8,806.4	13,686.1
B. MEDIUM-TERM	2,107.5	3,788.3	5,601.1	9,752.7	12,576.8	13,045.9
C. LONG-TERM	1,352.3	1,277.3	1,886.7	2,943.3	5,282.5	7,888.9
TOTAL (A+B+C)	6,102.9	8,280.1	11,841.1	18,430.9	26,665.7	34,620.9
Memorandum Items						
Nominal GDP (GH¢m)	36,597.6	46,042.0	59,816.0	75,315.0	94,939.0	113,436.0
Domestic Debt / GDP (%)	16.7	18.0	19.8	24.5	28.1	30.5

Source: BOG, MoFEP & GSS

Figure 3.6 Composition of Domestic Debt (percent)

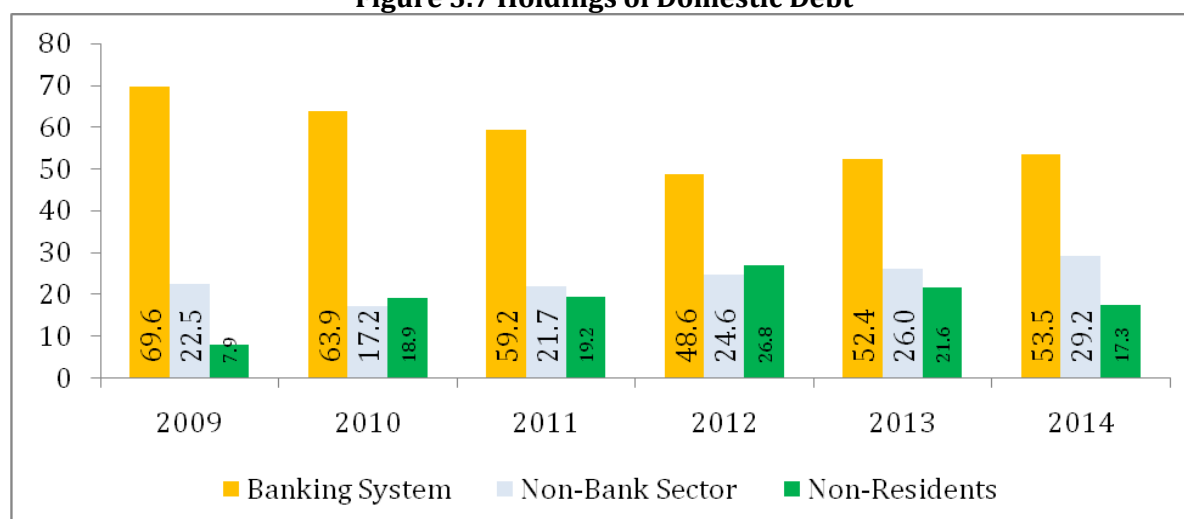


In general, over the two-year period, short-term debt increased the most. The apparent preference for short-term debt seems to reflect perceived uncertainty by investors. While long-term debt also increased, it will be necessary to have it increase further through intensified efforts to consolidate macroeconomic stability. This will also ease the burden of debt service given the relatively lower turn-over rate of long-term debt.

Table 3.6 Changes in Domestic Debt by Holder

HOLDER	2009	2010	2011	2012	2013	2014
A. Banking System	69.6	63.9	59.2	48.6	52.4	53.5
o/w Bank of Ghana	35.19	18.52	22.82	20.45	23.55	24.98
B. Nonbank Sector	22.5	17.2	21.7	24.6	26.0	29.2
C. Non-Residents	7.92	18.90	19.15	26.80	21.59	17.26
TOTAL(A+B+C)	100.0	100.0	100.0	100.0	100.0	100.0
Percentage Change in Holdings of Domestic Debt						
HOLDER	2008/2009	2009/2010	2010/2011	2011/2012	2012/2013	2013/2014
A. Banking System	30.5	24.5	32.4	27.9	55.9	32.7
o/w Bank of Ghana	14.7	-28.6	76.2	39.5	66.6	37.7
B. Nonbank Sector	20.1	4.0	80.1	76.4	53.2	45.6
C. Non-Residents	11.6	223.6	44.9	117.8	16.5	3.8
TOTAL(A+B+C)	27.1	35.7	43.0	55.7	44.7	29.8

Figure 3.7 Holdings of Domestic Debt



In terms of holdings of the domestic debt, the banking system increased its share from 48.6 percent in 2012 to 52.4 percent in 2013 and further to 53.5 percent in 2014. Most of the increase was accounted for by Bank of Ghana. The domestic non-bank sector also increased its share from 24.6 percent to 26.0 percent and further to 29.2 %. On the other hand, non-residents decreased their share from 26.8 percent to 21.6 percent and further to 17.3%. (Table 3.6 and Figure 3.7)

The continuous decline in non-resident holdings of the debt could be attributable to a number of factors, including speculation, perceived risks and waning confidence in the economy, especially given the severe difficulties experienced in the last few years.

The trend, if it persists, could put additional pressure on the cedi. It will be interesting, however, to see how a possible IMF bailout in 2015 would impact on investor sentiment going forward.

External Debt

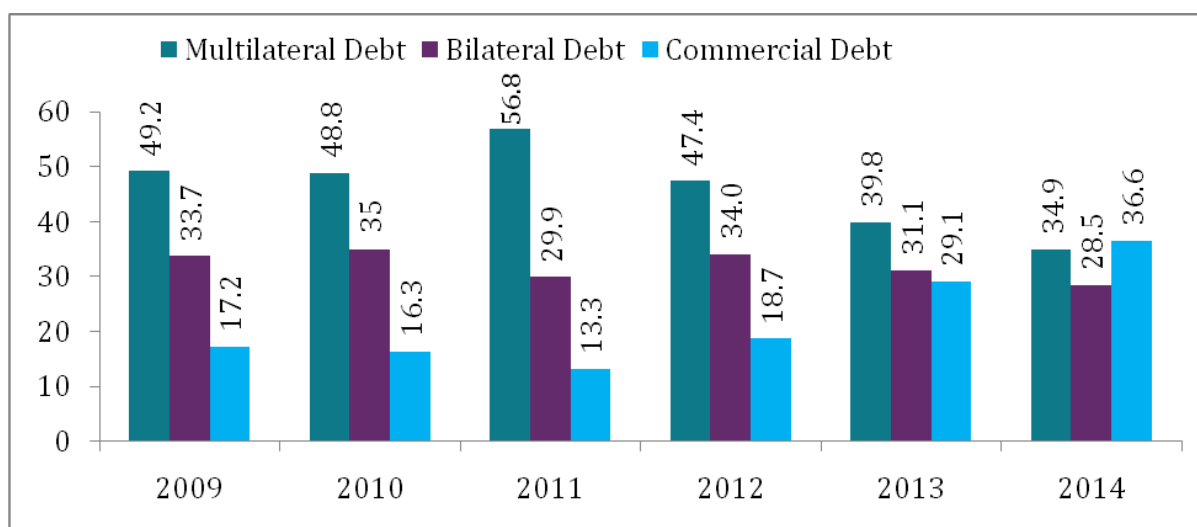
Ghana's external debt in 2013 increased by 25.2 percent over the 2012 level to US\$11,462 million. Significantly, the commercial component increased at the fastest rate of 95.5%, while multilateral debt increased by 5.1%. (Table 3.7 and Figure 3.8)

Table 3.7 External Debt by Creditor

External Debt (US \$m)	2009	2010	2011	2012	2013	2014
A. Multilateral	2,461.8	3,081.9	4,441.5	4,336.8	4,557.9	4,525.7
B. Bilateral	1,687.2	2,211.1	2,338.4	3,108.4	3,564.6	3,693.9
C. Commercial	858.9	1,027.7	1,036.1	1,708.4	3,339.2	4,748.6
TOTAL	5,007.9	6,320.7	7,816.0	9,153.6	11,461.7	12,968.2
Memorandum Items						
TOTAL EXTERNAL DEBT (GH¢)	7,154.8	9,315.4	12,118.6	17,208.8	25,215.8	41,499.5
Nominal GDP (GH¢ m)	36,597.6	46,042.0	59,816.0	75,315.0	94,939.0	113,436.0
External Debt / GDP (%)	19.5	20.1	20.3	22.8	26.6	36.6

Ghana's external debt in 2014 increased by 13.1 percent over the 2013 level to US\$12,968 million or 36.6 percent of GDP. As in 2013, commercial debt again increased at a fast rate of 42.2%, while multilateral debt actually declined by 0.7%.

Figure 3.8 Composition of External Debt

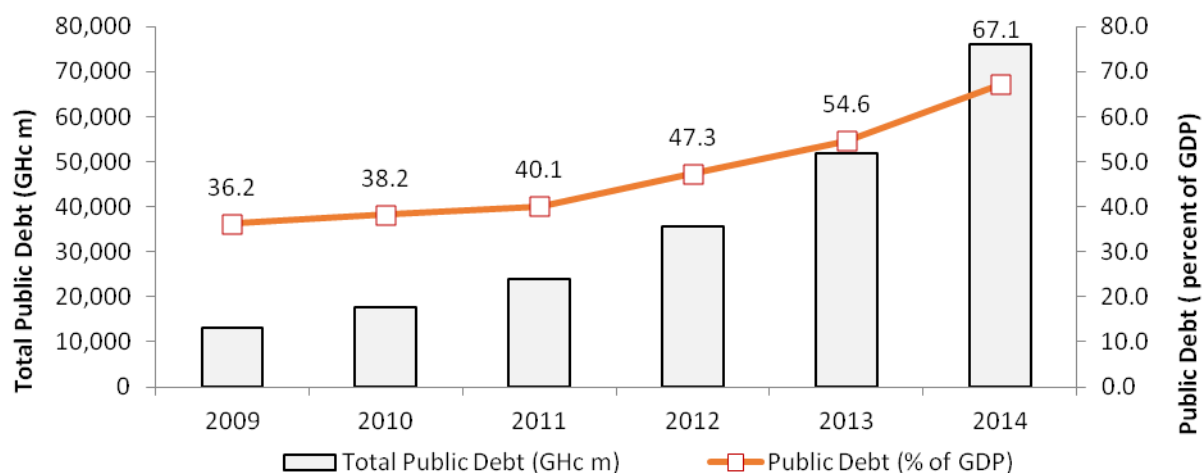


In 2014 commercial debt replaced multilateral debt as the largest component of external debt, accounting for 36.6%. This shift in the composition of external debt implies a greater debt burden because interest rates on commercial loans are typically much higher than those on concessionary multilateral debts.

Total Public Debt

Total public debt to GDP ratio has risen from 38.2 percent in 2010 to 55 percent in 2013 and sharply to 67 percent in 2014 (Figure 3.9).

Figure 3. 9 Total Public Debt



In 2014, the total public debt increased by GH¢24,239 million over the 2013 figure to GH¢76,120 million. Of the total public debt at the end of 2014, the domestic component accounted for a lower share of 45.5%, while the external component accounted for 54.5% (Table 3.8 and 3.9)

Table 3.8 Composition of Total Public Debt

Total	2009	2010	2011	2012	2013	2014
External Debt	7,154.8	9,315.4	12,118.6	17,208.8	25,215.8	41,499.5
Domestic Debt	6,103.0	8,280.2	11,841.2	18,431.0	26,665.7	34,620.9
Total Public Debt	13,257.8	17,595.6	23,959.8	35,639.8	51,881.5	76,120.37
Memorandum Items						
Nominal GDP (GH¢m)	36,597.6	46,042.0	59,816.0	75,315.0	94,939.0	113,436.0
Public Debt /GDP (%)	36.2	38.2	40.1	47.3	54.6	67.1
External Debt / GDP	19.5	20.2	20.3	22.8	26.6	36.6
Domestic Debt / GDP	16.7	18.0	19.8	24.5	28.1	30.5

Table 3.9 Percentage Share of Total Public Debt

Total	2009	2010	2011	2012	2013	2014
External Debt	54.0	52.9	50.6	48.3	48.6	54.5
Domestic Debt	46.0	47.1	49.4	51.7	51.4	45.5
Total Public Debt	100.0	100.0	100.0	100.0	100.0	100.0

As we see later in this volume, Ghana's public debt-to-GDP ratio of 67 percent in 2014 is regarded by many analysts to have already crossed the sustainability threshold of about 60 percent. After benefiting from HIPC and MDRI debt reliefs, Ghana's debt-to-GDP ratio dropped from unsustainably high levels to just 26 percent in 2006. The spree of subsequent borrowing to finance ever increasing budget deficits has returned the debt yet again to an unsustainable level. Short of curtailing the fiscal deficits, moving away from borrowing, as Ghana inevitably will be forced to do, may force an accommodative monetary policy which would eventually ignite inflationary pressures, force upward pressure on interest rates and weaken the financial system.

4. MONETARY AND FINANCIAL DEVELOPMENTS

Monetary policy in 2013 and 2014 generally aimed at:

- Maintaining price stability to provide an enabling environment for economic growth;
- Focusing on both domestic and external risks that may threaten the economy, while complementing Government's fiscal consolidation efforts;

- Continued enforcement by Bank of Ghana of prudent regulations to ensure soundness and stability of the financial system to enhance financial intermediation.
- End-of-year inflation targets of 9 percent and 9.5 percent were set respectively for 2013 and 2014.

and

The key monetary and financial developments in 2013 and 2014 were as follows:

- Monetary aggregates grew moderately in 2013 but accelerated in 2014.
- Inflation accelerated in 2013 and 2014 due to demand pressures from expansionary fiscal policies and cost-push effects of hikes in fuel and utility prices and from exchange rate depreciation.
- Bank of Ghana hiked its Policy Rate in 2013 and 2014 in response to rising inflation and pressures on the exchange rate. This led to increases in other interest rates, further worsening the high borrowing costs.

4.1 Key Monetary Aggregates

Table 4.1 Money Supply and Source of Monetary Growth

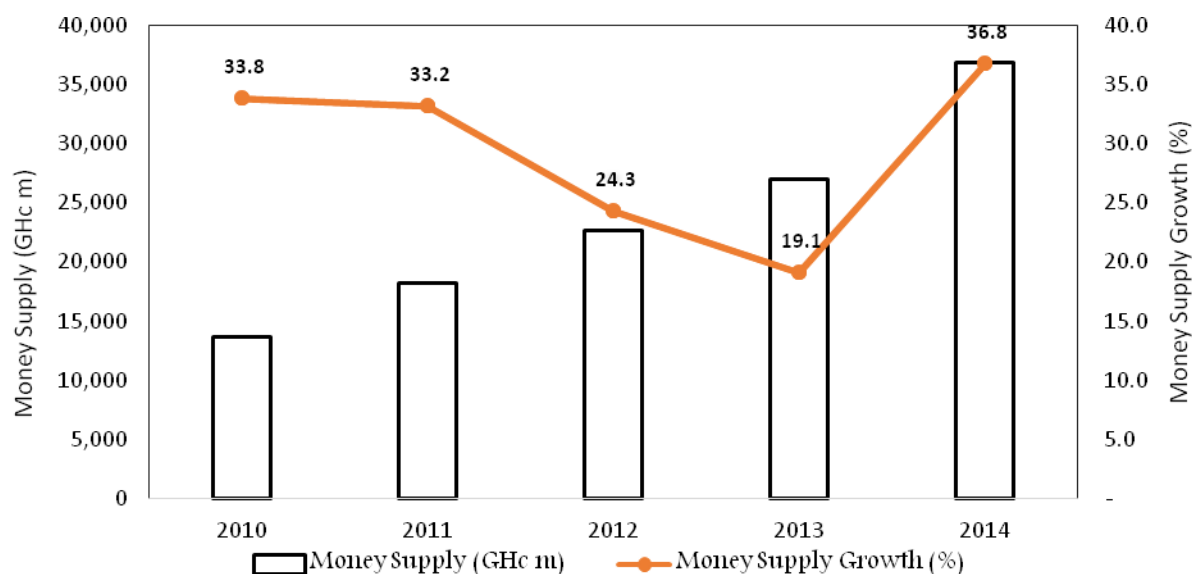
Indicator	2010	2011	2012	2013	2014	2012/2013 percent Change	2013/2014 percent Change
Money Supply (M2+)	13,663	18,195	22,619	26,937	36,843	19.1	36.8
Net Foreign Assets (NFA)	5,754	7,880	7,161	5,700	9,173	- 20.4	60.9
Net Domestic Assets (NDA)	7,909	10,315	15,458	21,237	27,670	37.4	30.3

Source: Bank of Ghana

Money supply in 2013, increased by 19.1 percent over its 2012 level to GH¢26,937 million. The increase was driven entirely by net domestic assets (NDA) of the banking system, which increased by GH¢5,779 million. Net foreign assets (NFA) exerted a partly-offsetting effect, declining by GH¢1,460 million (Table 4.1 & Figure 4.1).

In 2014, money supply increased by GH¢ 9,906 million or 36.8 percent to GH¢36,843 million. The increase was driven by both NDA and NFA, which increased by GH¢ 6,433 million and GH¢3,473 million respectively.

Figure 4.1 Money Supply Growth



The money growth rate in 2014 of 36.8 percent was nearly twice the growth in 2013. The level of money supply in 2014 was 170 percent higher than its 2010 level. The rise in net domestic assets by 249 percent between 2010 and 2014 has been more dramatic, indicating the expansionary nature of monetary policy during the past 5 years. Such growth is bound to exert a strong effect on inflation, usually expected after a lag of up to a year or so. The high monetary growth rate suggests that control measures have been largely ineffective and would need to be reinforced.

In 2013, reserve money, alternatively called high-powered money, increased by GH¢1,198 million or 15.2 percent to GH¢9,058 million. The increase was driven largely by NDA of the Bank of Ghana, which increased by GH¢1,036 million; NFA also increased by GH¢162 million (Table 4.2).

Table 4.2 Reserve Money and Sources of Growth

Indicator	2010	2011	2012	2013	2014	2012/2013 percent Change	2013/2014 percent Change
Reserve Money	4,410	5,780	7,860	9,058	11,785	15.2	30.1
Net Foreign Assets (NFA)	5,241	6,670	5,781	5,943	8,678	2.8	46.0
Net Domestic Assets (NDA)	- 831	- 890	2,079	3,115	3,107	49.8	-0.3

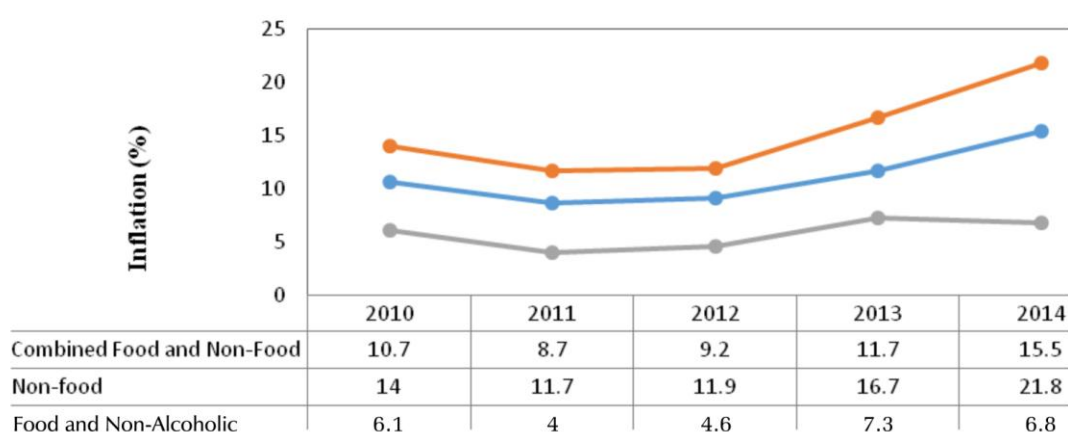
Source: Bank of Ghana

In 2014, reserve money increased by GH¢2,727 million or 30.1 percent to GH¢11,785 million. The increase was driven exclusively by NFA, which increased by GH¢2,735 million, while NDA exerted a partly-offsetting, albeit marginal, decline of GH¢8 million.

4.2 Inflation

In 2013, average inflation rose to 11.7 percent from 9.2 percent in 2012. And in 2014, it rose further to 15.5%. On a year on year basis, inflation rose to 13.5 percent in 2013 from 8.8 percent in 2012. And in 2014, it rose yet sharply to 17.0%, which was the highest level since 2008. Over the two-year period, (average) non-food inflation was much higher (at 16.7 percent in 2013 and 21.8 percent in 2014) than food inflation (at 7.3 percent in 2013 and 6.8 percent in 2014) (Figure 4.2).

Figure 4.2 Average Food and Non-Food Inflation (percent)



Inflationary pressures generally increased in 2013 and 2014 due to demand pressures from expansionary fiscal policies and cost-push effects of hikes in fuel and utility prices and from exchange rate depreciation.

4.3 Interest Rates

Responding to increasing inflation and also to pressures on the exchange rate—which accelerated in 2014—the Bank of Ghana increased its Policy Rate (PR) from 15 percent in 2012 to 16 percent in 2013 and further to 21 percent in 2014. Other rates generally followed this trend. The 91-Day Treasury Bill rate increased from 18.8 percent in 2012 to 19.2 percent in 2013 and further to 25.8 percent in 2014; the (average) banks' savings deposit rate increased from 5.3 percent in 2012 to 5.8 percent in 2013 and then declined to 5 percent in 2014; and the (average) banks' lending rate declined marginally from 25.7 percent in 2012 to 25.6 percent in 2013 and then increased to 29 percent in 2014 (Table 4.3).

Table 4.3 Implicit Real Interest Rates

		2010	2011	2012	2013	2014
Prime Rate (Policy Rate)	Nominal	13.5	12.5	15.0	16.0	21.0
	Real	2.8	3.8	5.8	4.342	5.55
Demand Deposit (Annual Av)	Nominal	3.4	3.4	3.4	3.4	3.5
	Real	-7.3	-5.3	-5.8	-8.278	-11.95
Savings Deposit (Annual Av)	Nominal	5.9	4.1	5.3	5.8	5.0
	Real	-4.8	-4.6	-3.9	-5.908	-10.45
Lending Rate (Annual Av)	Nominal	27.6	27.5	25.7	25.6	29.0
	Real	16.9	18.8	16.5	13.902	13.53
Treasury Bill Rate (91-Day)	Nominal	14.4	10.7	18.8	19.2	25.8
	Real	3.7	2	9.6	7.542	10.35
Interest Rate Spread						
Average Lending Rate-Policy Rate		14.1	15.0	10.7	9.6	8.0
Average Lending Rate-Demand Deposit Rate		24.2	24.1	22.3	22.2	25.5
Average Lending Rate-Savings Deposit		21.7	23.4	20.4	19.8	24.0
Average Lending Rate-T' Bill Rate		13.2	16.8	6.9	6.4	3.2
Memorandum						
Inflation Rate		10.7	8.7	9.2	11.658	15.45

Source: Bank of Ghana

Borrowing costs have been persistently high in Ghana. The business community continually cites the cost of credit as one of the most important obstacles confronting them. The problem is the result of high level of Government borrowing, macroeconomic instability, high operational costs of banks and high borrower risks. To bring the cost of credit down would require a multi-pronged attack on these causes.

4.4 Developments in the Banking Sector

Banking activities showed strong growth in 2013. The combined assets/liabilities of banks increased by GH¢8,805 million or 32 percent to GH¢36,230 million. On the assets side, claims on the private sector increased the most by GH¢3,280 million to GH¢14,757 million, followed by claims on government, which increased by GH¢2,514 million to GH¢7,504 million. On the liabilities side, private sector deposits increased the most by GH¢3,404 million to GH¢20,132 million, followed by foreign liabilities, which increased by GH¢2,124 million to GH¢3,078 million and then by paid-up capital and reserves, which increased by GH¢1,696 million to GH¢5,733 million (Table 4.4 & Figure 4.3).

Figure 4.3 Assets of Deposit Money Banks (GH¢, millions)

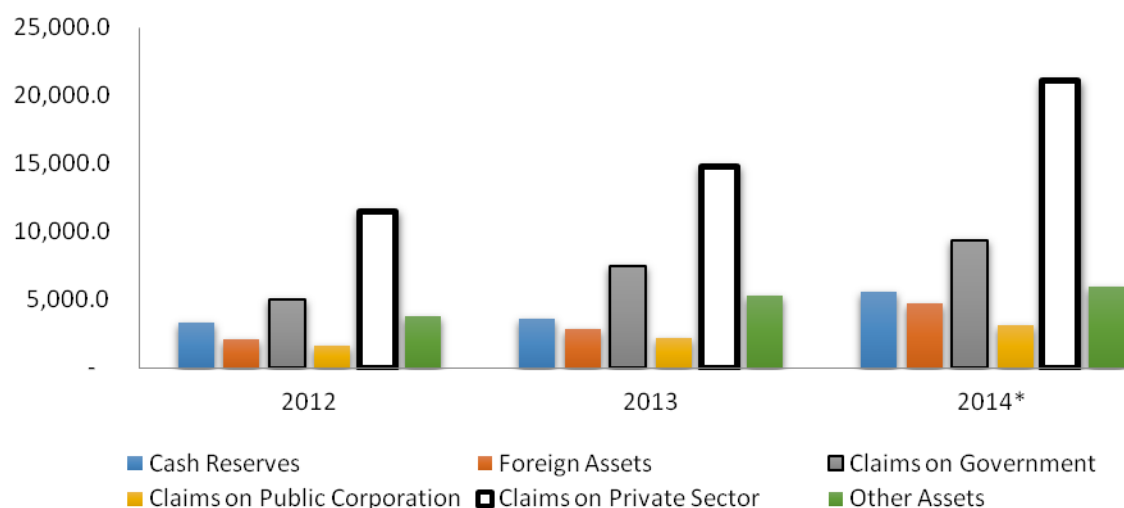


Figure 4.4 Liabilities of Deposit Money Banks (GH¢, millions)

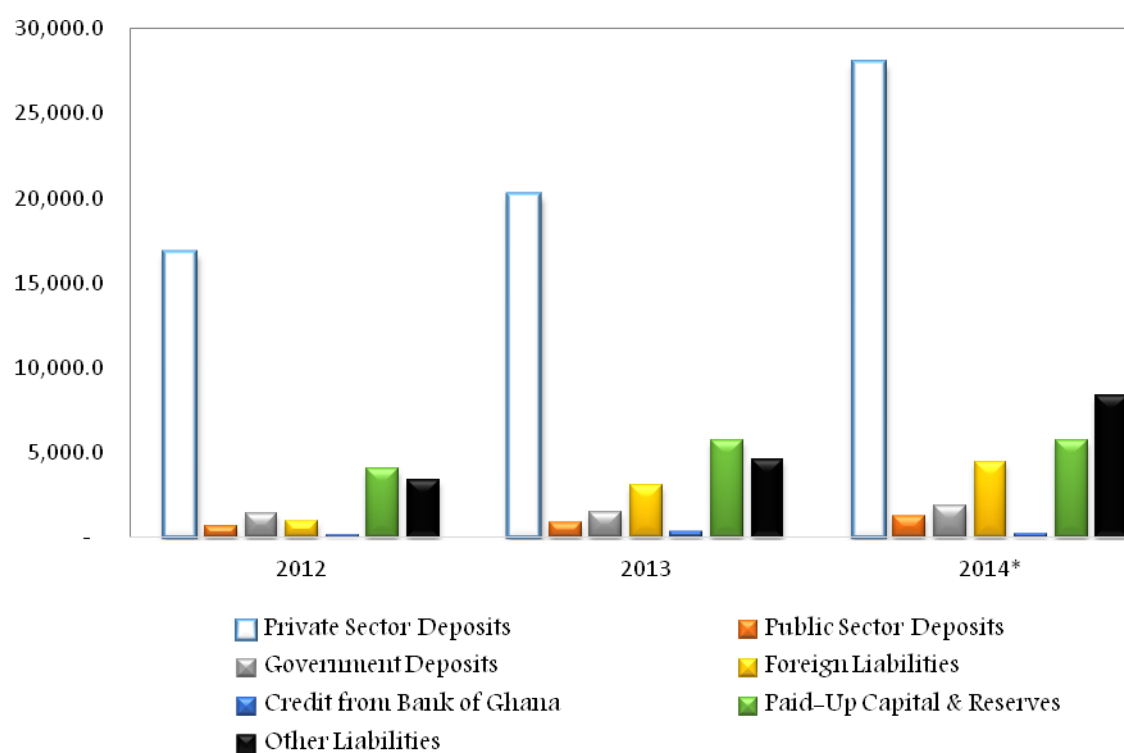


Table 4.4 Assets of Deposit Money Banks (GH¢, millions)

Indicators	2011	2012	2013	2014*	2012/2013 percent Change	2013/2014 percent Change
Cash Reserves						
Cash in Till	481	636.9	697.7	846	9.5	21.2
Balance at Bank of Ghana	2,280.8	2,692.8	2,947.8	4,731.6	9.5	60.5
Total	2,761.8	3,329.7	3,645.5	5,577.5	9.5	53
Foreign Assets	1,953.8	2,126.9	2,805.9	4,737.8	31.9	68.9
Claims on Government						
Government Stocks	2,615.5	2,914.8	5,107.8	3,835.7	75.2	24.9
Treasury Bills	946.4	1,393.2	1,714.3	4,829	23	181.7
TOR Bonds	682	682	682	682	0	0
Total	4,243.9	4,990	7,504.1	9,346.8	50.4	24.6
Claims on Public Corporation						
Other Bills	297.2	113.9	17.4	78.2	84.7	348.2
Loans & Advances	791.5	1,548.2	2,205.8	3,053.2	42.5	38.4
Total	1,088.7	1,662	2,223.3	3,137.3	33.8	41.1
Claims on Private Sector	8,752.4	11,477.4	14,757.2	21,042.7	28.6	42.6
Other Assets	2,809	3,838.7	5,293.8	5,979	37.9	12.9
Total Assets	21,609.5	27,424.7	36,229.7	49,821.1	32.1	37.5

Source: Bank of Ghana Statistical Bulletin

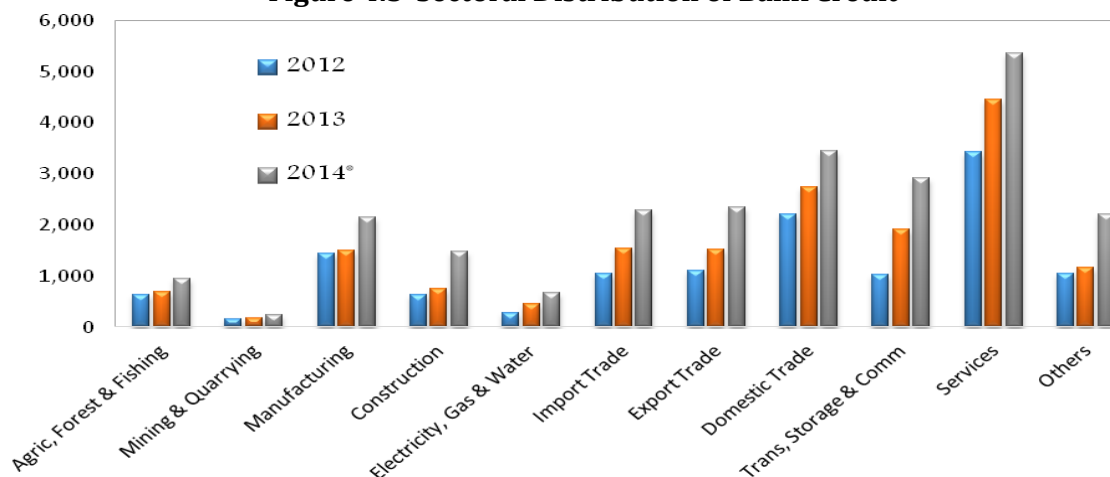
The strong growth in banking activity continued in 2014. The total assets/liabilities of banks increased by GH¢13,591 million or 38 percent to GH¢49,821 million. On the assets side, claims on the private sector increased the most by GH¢6,286 million to GH¢21,043 million followed by claims on government, which increased by GH¢1,843 million to GH¢9,347 million. On the liabilities side, private sector deposits increased the most by GH¢7,785 million to GH¢27,917 million, followed by foreign liabilities, which increased by GH¢1,346 million to GH¢4,424 million.

Table 4.5 Liabilities of Deposit Money Banks (GH¢, millions)

Indicators	2011	2012	2013	2014*	2012/2013 percent Change	2013/2014 percent Change
Private Sector Deposits						
Demand Deposits	4,337.1	5,533	6,447.6	8,881.1	16.5	37.7
Foreign Currency Deposits	3,954.2	5,116.8	6,245	9,313	22	49.1
Savings Deposits	2,554.5	3,339.9	3,785.3	4,406.7	13.3	16.4
Time Deposits	2,520.6	2,738.5	3,654.5	5,316.5	33.4	45.5
Total	13,366.4	16,728.2	20,132.4	27,917.3	20.3	38.7
<i>percent of GDP</i>	<i>22.35</i>	<i>22.21</i>	<i>21.21</i>	<i>24.61</i>		
Public Sector Deposits						
Demand Deposits	437.9	430	531.2	711.3	23.5	33.9
Savings Deposits	3.3	5.9	2.2	2.7	63.1	25.1
Time Deposits	448.2	262.2	347.5	546.6	32.5	57.3
Total	889.4	698.2	880.9	1,260.7	26.2	43.1
<i>percent of GDP</i>	<i>1.49</i>	<i>0.93</i>	<i>0.93</i>	<i>1.11</i>		
Government Deposits	1,006.4	1,413.4	1,483.5	1,889.7	5	27.4
Foreign Liabilities	743.4	954.5	3,078.2	4,424.3	222.5	43.7
Credit from Bank of Ghana	80.6	175.1	333.9	241.2	90.7	27.8
Paid-Up Capital & Reserves	3,048.2	4,037.2	5,733.4	5,733.4	42	0.0
Other Liabilities	2475.1	3418.1	4587.54	8354.55	34.2	82.1
Total Liabilities	21609.5	27424.7	36229.71	49821.05	32.1	37.5
<i>percent of GDP</i>						
Memorandum						
Nominal GDP	59816	75315	94939	113436	26.1	19.5

In 2013, commercial banks' credit to public institutions and the private sector increased by GH¢ 4,595 million or 31.5 percent to GH¢19,169 million. Credit to public institutions increased by GH¢658 million or 42.5 percent to GH¢2,206 million, while credit to the private sector increased by GH¢3,938 million or 30.2 percent to GH¢16,963 million. The increase in credit to the private sector went largely to services (GH¢1,021 million), transport, storage and communications (GH¢889 million) and domestic trade (GH¢540 million). Cocoa marketing (GH¢8 million), mining & quarrying (GH¢20 million), agriculture, forestry and fishing (GH¢60 million) received the least credit (Table 4.5).

In 2014, commercial banks credit to public institutions and the private sector increased by GH¢7,986 million or 41.7 percent to GH¢27,155 million. Credit to public institutions increased by GH¢847 or 38.4 million to GH¢3,053 million, while credit to the private sector increased by GH¢7,139 million or 42.1 percent to GH¢24,102 million. The increase in credit to the private sector went largely to miscellaneous sectors (GH¢1,035 million), transport, storage and communications.

Figure 4.5 Sectoral Distribution of Bank Credit

(GH¢1,001 million) and services (GH¢911 million). Cocoa marketing (GH¢13 million), mining & quarrying (GH¢68 million), and agriculture, forestry and fishing (GH¢256 million) received the least credit.

Based on the broad sectors of the economy—agriculture, industry and services—services seem to have a commanding share of outstanding credit in 2013 and 2014 followed by industry and agriculture. This skewed pattern of credit allocation has long prevailed and seems to be driven by profit and risk. It may be necessary for Government intervention to introduce specialised financing schemes for the bedrock agriculture and manufacturing sectors particularly.

4.5 Developments in the Ghana Stock Exchange

In 2013, total market capitalisation of the Ghana Stock Exchange (GSE) increased by GH¢3,894 million or 6.8 percent to GH¢ 61,158 million. The number of listed companies remained the same at 34. The GSE Composite Index (CI) and Financial Stock Index (FSI), both of which measure the share values, increased by 78.8 percent and 71.8 percent respectively to GH¢2,145 million and GH¢1,787 million (Table 4.6).

Table 4. 6 Key Stock Exchange Indicators

Indicators	2010	2011	2012	2013	2014
Market Capitalization (GSE) (GH¢)	20116.7	47350.2	57264.22	61158.3	64352.4
GSE All Share Index	7369.2	-	-	-	-
Composite Index	-	969	1199.72	2145.2	2243.63
Financial Stock Index	-	863.1	1039.86	1786.6	2261.02
Number of Listed Companies	35	34	34	34	35

Source: Ghana Stock Exchange

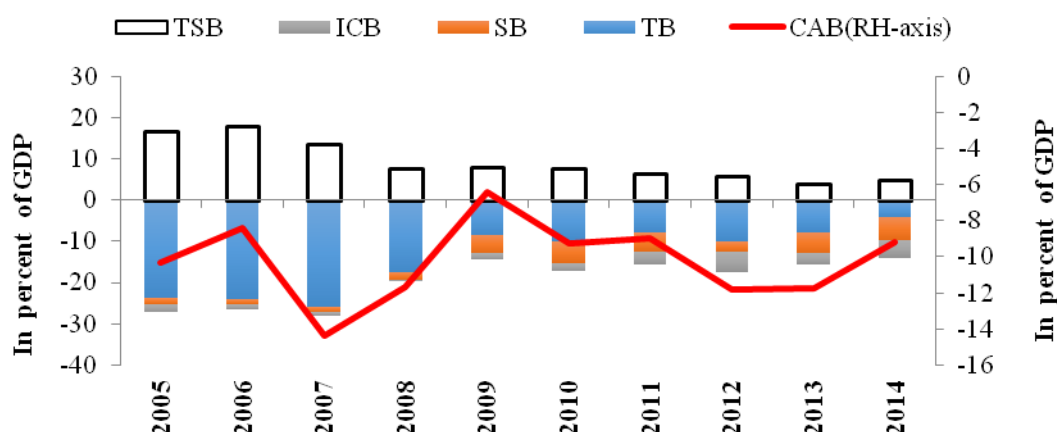
In 2014, total market capitalisation of the Ghana Stock Exchange (GSE) increased further by 3,194 million or 5.2 percent to GH¢ 64,352 million. The number of listed companies increased by 1 to 35. The GSE Composite Index and Financial Stock Index increased by 4.6 percent and 26.6 percent respectively to GH¢2,244 million and GH¢2,261 million.

5. TRENDS IN INTERNATIONAL TRADE AND BALANCE OF PAYMENT

- Ghana's trade balance deficit of 4.1 percent of GDP in 2014 was nearly twice lower than the deficit of 7.9 percent in 2013 and much lower than the 10.2 percent of GDP in 2012.
- The current account deficit of US\$3.6 billion in 2014, equivalent to 9.2 percent of GDP was marginally higher than the 9 percent of GDP in 2011, but was a substantial improvement over the 2012-2013 average deficit of 11.8 percent of GDP.
- The structural economic downturn driven by high interest rates, rising import costs due to the cedi depreciation and modest improvements in exports, largely account for the positive changes in the current account deficit in 2014 as businesses and households demand? for capital, intermediate and consumer goods fell, leading to a noticeable drop in non-oil imports in 2014.
- Ghana's capital and financial transactions with the rest of the world continued to be influenced by inflows of direct investment (largely into oil related businesses), portfolio investments (mostly debt securities) issued to both residents and non-resident investors, and government foreign borrowings as well as grants from donors.
- The capital and financial account saw net inflows of US\$3.2 billion (8.4 percent of GDP) in 2014 lower than the net inflows of US\$5.4 billion (11.0 percent of GDP) in 2013, only slightly lower than the US\$3.7 billion (8.8 percent of GDP) in 2012.

5.1 Current Account and the Underlying Trends

Ghana's current account deficit improved in 2014, buoyed by early depreciation of the national currency against the United States dollar and all the major trading foreign currencies boosting exports marginally and slowing down imports. The trend continued for most part of the year until the last quarter of 2014. An anticipated program with the IMF coupled with major foreign capital inflows from a sovereign Euro-bond issuance (US\$1.0 billion) and Ghana Cocoa Board loan syndication (US\$1.8 billion), all contributed to calm the market. The year-on-year improvement of US\$2.1 billion was however, much in contrast with deteriorations of US\$0.8 billion in 2013, and US\$1.4 billion in 2012.

Figure 5.1 International Trade Balances

Ghana's current account as a percentage of GDP (TSB – current transfer balance; ICB – investment income balance; SB – services balance; TB – trade balance; CAB – current account balance)

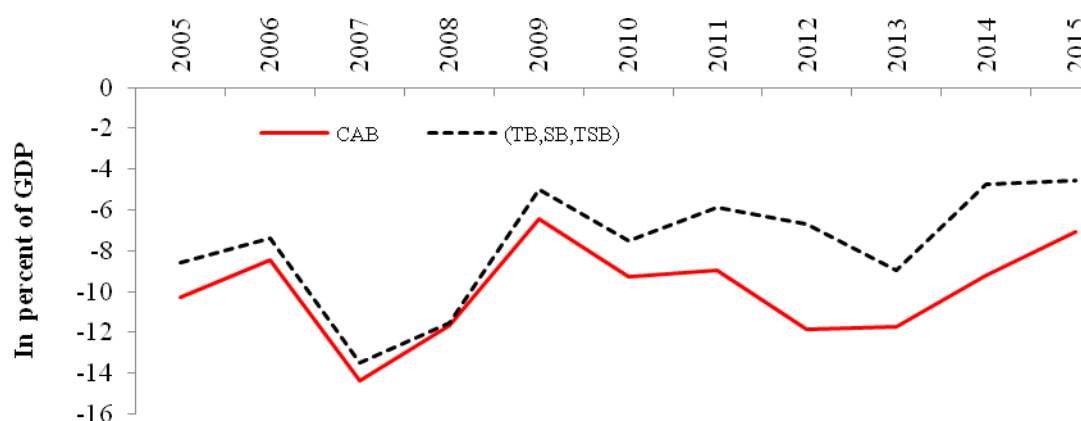
In addition to the trade balance deficit, investment income and trade in services, too, have been recording increasingly sizeable deficits in the past decade. This is broadly linked to the sharp increase in Ghana's net external liabilities and domestic debt. About one-fourth of domestic debt at the end-2013 was held by non-residents investors². This, coupled with profits and dividends, repatriated by entities with interest in Ghana, especially in crude oil business investment, construction, mining and telecommunication sectors of the economy, underlie the financial outflows and the service balance.

The services sector has recorded growing net outflows in the recent past. One reason for this trend is that most of the services are rendered to international service providers by resident corporations and government entities especially in freight and insurance services which relates mostly to imports of goods, international transport and logistics business, providers of IT services and construction sector.

The surplus recorded for unilateral transfers mostly from the United States and Canada, the EU and United Kingdom from private individual remitters and non-profit institutions serving households (NPISH's) in Ghana have grown steadily over the years, although year-on-year growth was almost flat in 2014. This slow down can be linked to the international economic environment, especially, with the main transfer corridors attributed to slow economic recoveries from the originating countries, strengthened by tighter financing conditions and weaker labour markets restrained resident migrants from remitting more in both 2013 and 2014.

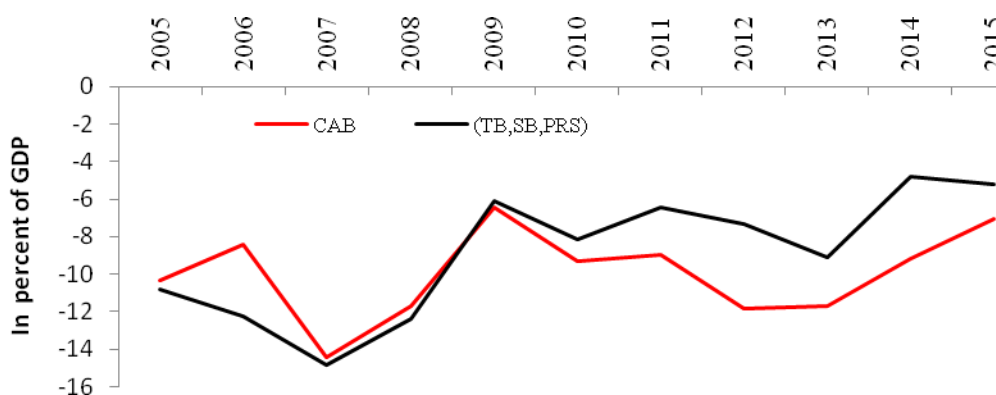
² Ghana - IMF 2014 article IV consultation staff report No, 14/129

Figure 5.2 Current Account and Trade Balances



The combined effect of trade balance, trade in services and unilateral transfers as percent of GDP, mimics the overall current account drift. (CAB – current account; TB – trade balance; SB – trade in services balance; TSB -- unilateral transfers)

Figure 5.3 Capital Account, Financing Gap and Financing



The combined effect of trade balance, trade in services and private remittances as a percentage of GDP, mimics the overall current account drift. (CAB -- current account; TB – trade balance; PRS – private remittances).

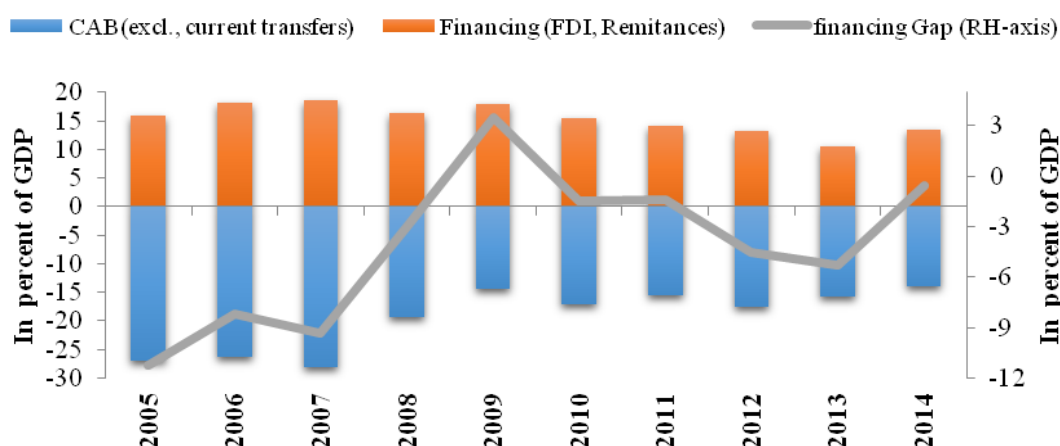
Moreover, the rapid depreciation of the cedi by close to 15 percent in 2013 and more than 25 percent in 2014 may have compelled remitters to switch from the formal to informal channels as an alternate mode of transfer. Besides, the trade transactions, investment income and unilateral transfers and private remittances also explained the overall current account trends.

The current account covers transactions that generally can be regarded as irreversible once they have occurred. Against the different possible explanations to the current account trends, any policy prescriptions to address Ghana's current account deficit and its effect on economic developments, have to involve policy changes in foreign trade, trade in services, investments income originated mainly from external liabilities including debt, unilateral transfers especially, private individual remittances from Ghanaian resident migrants in (U.S and Canada, the EU, UK and the ECOWAS region).

The current account deficit of US\$3.6 billion in 2014, equivalent to 9.2 percent of gross domestic product (GDP) was marginally higher than the 9 percent of GDP in 2011, but was a substantial improvement over the 2012-2013 average deficit of 11.8 percent of GDP.

The sum of Ghana's non-debt creating net flows³ financed current account deficit (excluding current transfers), amounts to a total net financing needs of US\$5.2 billion, which equates to 13.5 percent of GDP in 2014. This creates a gap of 0.5 percent of GDP (a deficit gap equivalent to US\$0.19 billion financed) in 2014, most often financed by net debt creating inflows such as the portfolio investment, government borrowings (in the form of loans), private sector borrowings, monetary short-term and non-monetary short-term capital. These financing items are frequently subject to reversals, even in the short run, leaving reserve assets as the next most reliable sources of financing transactions.

Figure 5.3 Capital Account, Financing Gap and Financing



Given this background, any weakening in terms-of-trade or larger outflows of foreign capital through portfolio investment, private sector or reversal of grants, always have immense consequence on international reserves and most often trigger more drastic cedi depreciation and import contraction. The costs in terms of deterioration in fiscal deficit, contraction in growth prospects and employment may diminish efforts needed to restore stability to the economy.

5.2 Merchandise Trade Flows, Trade Balance and Terms of Trade

For the first time since 2009, Ghana's foreign trade year-on-year decreased by US\$3.8 billion, this equates to 9.8 percent of GDP in 2014. Nominal exports of goods fell by 5.6 percent after growing slightly by 1.5 percent in 2013. Nominal imports of goods were 17.2 percent down, largely explained by 22.4 percent decline in non-oil imports in the year.

³ This consists of net FDI flows and private remittances excluding donor grants.

Table 5.1 Foreign Trade by Regular Export and Import Corridors

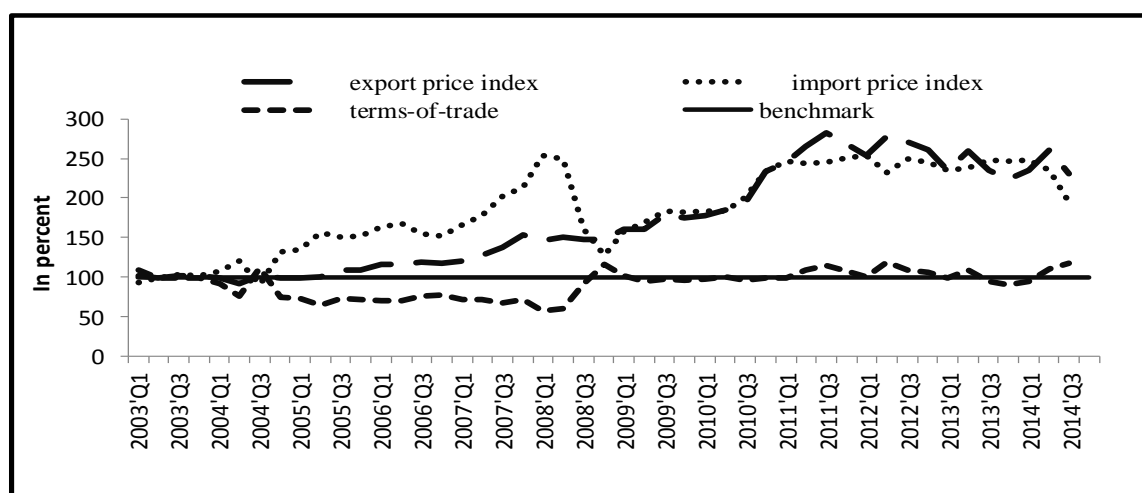
Country/Group of countries	% Share	Annual Percentage Change		
	2014	2012	2013	2014
Goods Exports				
EU area	26.4	-18.7	2.5	-20.1
<i>of which:</i>				
Netherlands	5.9	-4.3	11.2	-29.8
France	6.2	-62.9	-4.0	-18.2
UK	2.7	-25.7	17.4	-8.4
Italy	5.1	26.3	-4.0	-36.8
Other EU countries	12.3	7.7	-3.0	-14.4
<i>of which:</i>				
Switzerland	8.1	23.8	-1.3	-18.1
Far East countries	1.4	51.5	7.2	139.4
<i>of which:</i>				
China	5.1	0.0	-21.4	47.6
India	5.1			
Africa countries	31.3	21.4	4.6	-12.6
<i>of which;</i>				
South Africa	23.6	26.3	-9.8	-3.6
Other countries	11.2	30.5	15.4	-81.1
All countries	00.0	6.0	1.5	-5.6
Goods Imports				
EU area	34.0	4.7	50.3	-18.1
<i>of which;</i>				
Netherlands	11.0	62.1	165.9	-9.7
UK	3.2	-6.9	19.8	-27.6
Belgium	4.3	-12.0	34.9	-36.4
Germany	2.6	-	-	-19.5
Other EU countries	5.4	17.9	20.6	-3.2
Far East countries	28.7	-5.6	23.1	-19.3
<i>of which;</i>				
China	13.3	-0.2	17.6	-13.7
India	3.7	-10.8	20.7	-13.3
Africa countries	15.1	103.1	24.8	-38.0
<i>of which;</i>				
South Africa	2.5	10.4	-6.6	-18.4
Other countries	16.8	-5.3	29.4	-55.0
<i>of which:</i>				
United States	6.2	-3.7	8.5	-29.1
All countries	100.0	12.2	-0.9	-17.2

In 2014, Ghana's overall exports of goods stagnated and more pronounced differences in regional trends were observed than in 2013. The value of goods delivered to the euro zone contracted, the year-on-year decrease of 20.1 percent was distinctly worse than 2013 (an increase of 2.5 percent). Goods deliveries were mainly to the Netherlands, France, the United Kingdom and Italy. Exports to non-European markets recorded a decline of 14.4 percent in 2014 clearly smaller than in 2013 (3 percent).

Beginning 2012 to 2014, very high rates of growth had been recorded for exports to the Far East markets, exports deliveries to China increased by 47.6 percent in 2014 after a decrease of 21.4 percent in 2013. Deliveries of exports to Africa markets, especially to the South Africa market fell by 3.6 percent in 2014 after a higher decline of 9.8 percent in 2013. Ghana's exports to other economies including United Arab Emirates, declined by 81.1 percent after successive high growth rates of 30.5 percent in 2012 and 15.4 percent in 2013.

The distinct decline in imports of goods in 2014 was attributable to the economic downturn in Ghana, driven by high interest rates, rising import costs due to the cedi depreciation that depressed private sector activity. Ghana's enterprises and households primarily decreased their demand for capital, intermediate and consumer goods during the year under review.

Figure 5.4 Trends in Export and Import Price Indexes and Terms of Trade



The euro zone benefitted to a large extent from Ghana's import demand, although, it fell by 18.1 percent in 2104 after a successive increases in 2012 by 4.7 percent and 50.3 percent in 2013. The Far East countries driven mostly by China and India benefitted, although demands for imports fell by 19.3 percent in 2014 after a pickup in 2013 by 23.1 percent.

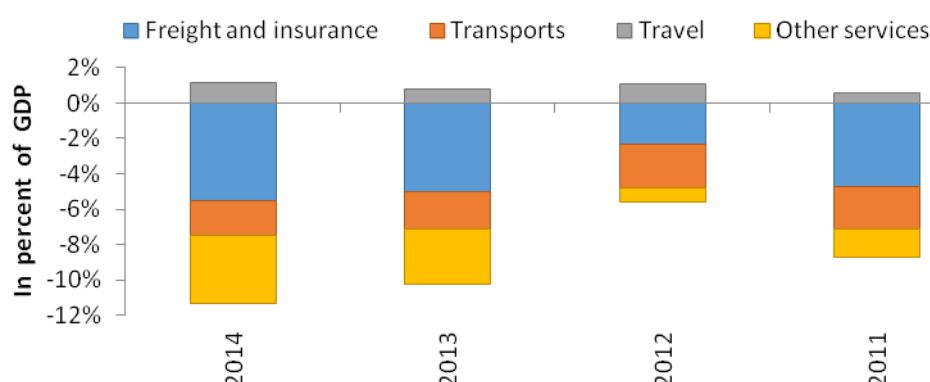
The African economies, led by South Africa, benefitted from Ghana's high import demand, but decreased by 38 percent after successive increases in 2012 and 2013 by 103.1 percent and 24.8 percent respectively. Imports from other economies (including United States) also fell by 55.0 percent after a pickup in 2013 by 29.4 percent.

Overall, Ghana's structural trade deficit improved by US\$2.3 billion (5.8 percent of GDP) to US\$1.6 billion (4.1 percent of GDP) in 2014. This decline was solely attributable to non-oil imports compression, triggered by high interest rates, rising import costs due to the cedi depreciation that depressed private sector activity during the year. On the balance, the terms-of-trade improved over the levels recorded a year ago, but was generally unfavorable to Ghana's economy in 2014.

5.3 Balance on Trade in Services

Services business offered mostly by Ghana's government agencies and private enterprises to non-residents providers reduced in 2014 in comparison with 2013. This was because most of the services are linked to freight and insurance services driven mostly by foreign trade in goods, international transports and logistic businesses, telecommunication services and construction services.

Figure 5.5 Major Trends in net Trade in Services



Illustrates the major trends in net trade in services offered by non-residents providers from the rest of the world scaled by GDP.

For instance, the balance on the freight and insurance sub-account further improved by US\$0.26 billion to a deficit of US\$0.76 billion (2.0 percent of GDP) in 2014 compared with a marginal decline of 0.3 percent to US\$1.02 billion (2.1 percent of GDP) in 2013.

Transports and logistics however, worsened by 14.7 percent to a deficit of US\$0.33 billion (0.8 percent of GDP) in 2014 compared with US\$0.26 billion deterioration to a deficit of US\$0.29 billion (0.6 percent of GDP) in 2013. Other services which most consisted of construction, telecommunications (including IT services), mining, financial services and oil related services slightly improved by 2.0 percent to a deficit of US\$1.5 billion (3.8 percent of GDP) in 2014, almost similar to 2013 deficit of US\$1.5 billion (3.1 percent of GDP).

Ghana's net receipts from foreign travels mostly from business, education and personal travels have seen a trend of rising net surpluses.

In 2014, a surplus of US\$0.44 billion (1.1 percent of GDP) was recorded compared with a net receipt of US\$0.38 billion (0.8 percent of GDP) in 2013. The overall balance on trade in services account registered a deficit of US\$2.1 billion (5.5 percent of GDP) in 2014, an improvement of US\$0.30 billion from US\$2.4 billion (5.0 percent of GDP) in 2013.

Balance on Investment Income

Over the past ten (10) years, Ghana has witnessed a growing trend in net investment income deficits. This is largely linked to the sharp increase in Ghana's net external liabilities and domestic debt, of which about one-fourth at the end-2013 was held by non-resident investors.

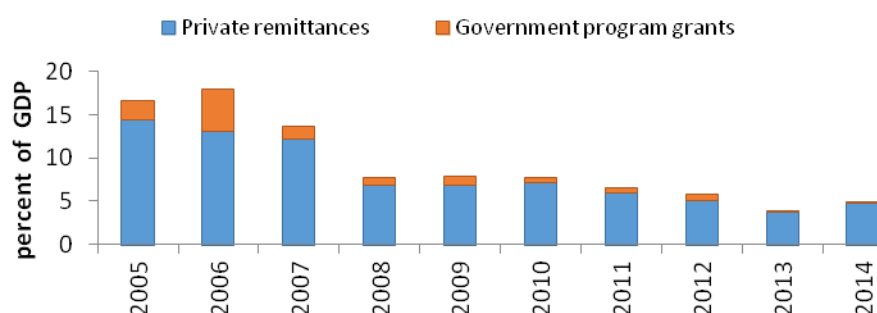
This development reflected in significant yield effects, coupled with profits and dividends, repatriated by entities with long lasting financial and economic interest in Ghana; driven largely by investments in the crude oil business, construction, mining and telecommunication (including providers of IT services) in the economy. In 2014, net investment income outflows grew by US\$0.30 billion to a deficit of US\$1.7 billion (4.3 percent of GDP) compared with a deficit of US\$1.4 billion (2.8 percent of GDP) in 2013.

Balance on Unilateral Transfers

Unilateral transfers from the rest of the world come in the form of government program grants from donor partners and private remittances from resident migrants' mostly living in United States, United Kingdom, the European Union area and the ECOWAS region.

The surpluses recorded for unilateral transfers mostly from private individual remitters and non-profit institutions serving households in Ghana have grown steadily over the years, although year-on-year growth was almost flat in 2014. This is linked to the international economic environment, especially, with the main transfer corridors which were characterized by fluctuations and mixed developments across these countries.

Figure 5.6 Trends of Unilateral Transfers by Private Remittances



The rates of economic recoveries were slower, strengthened by tighter financing conditions on the world financial markets, further fiscal consolidation relatively tight credit conditions and weaker labour markets further restrained resident migrants with businesses and strong family tights in Ghana to remit more in both 2013 and 2014.

Moreover, in Ghana, the domestic economy was not spared, the cedi depreciated by close to 15 percent in 2013 and more than 25 percent in 2014, these developments may have compelled remitters to switch from formal to informal channels as an alternate mode of transfer, thus contributing to lower volumes recorded. The balance on unilateral transfers account decreased by 3.1 percent to a surplus of US\$1.9 billion (4.8 percent of GDP) compared with a decrease of 19.4 percent to a surplus of US\$1.9 billion (4.0 percent of GDP) in 2013.

5.4 Capital and Financial Transactions and Underlying Trends

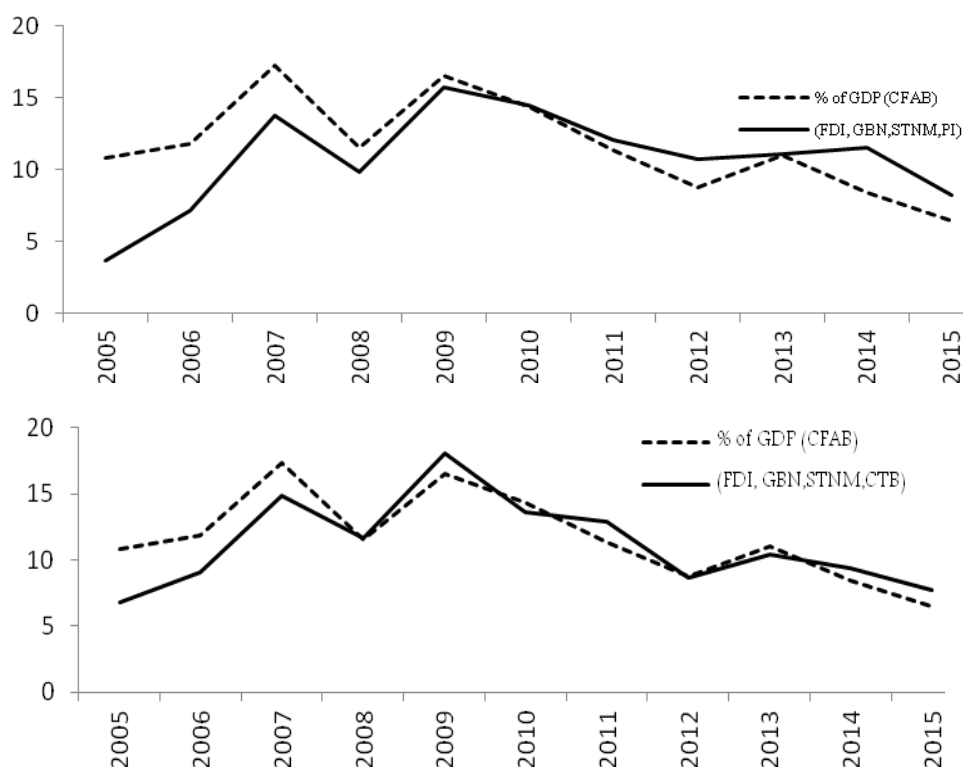
Transactions on the current account represented only a part of the volume of international financial flows between Ghana and the rest of the world.

In 2014, Ghana's capital and financial account witnessed net inflows of US\$3.2 billion (8.4 percent of GDP) compared with net inflows of US\$5.4 billion (11.0 percent of GDP) in the previous year. This was particularly due to other investment net outflows, which reflected primarily in the reduction in medium and long-term government net external borrowings as a result of shortfall in loans disbursements, Ghana's net flows under the oil investment abroad indicated a net drawdown from investment as an additional financing of the domestic budget, while the private sector including short-term trade credits such as the COCOBOD syndicated loan facility (meant for domestic cocoa purchases) and changes in deposit-taking corporations' foreign assets and liabilities added to the net outflows of capital in 2014.

The capital net outflows where partly offset by net inflows of foreign direct investment and portfolio investment during 2014; the latter consisted mainly of the sovereign bond of US\$1 billion issued in the last quarter of 2014.

Over the past ten years, Ghana has witnessed a trend influenced largely by the sum of all net inflows of foreign direct investment, general government external borrowings (loans), cocoa loan drawdown, and government project grants. The total net external financing from these sources almost sufficiently mimics the entire capital and financial account from 2005 to 2014.

This suggests, arguably that most of Ghana's net financing needs (excluding reserve assets) of the current account deficit come from FDI, general government external borrowings (loans), cocoa loan syndication and grants or from an alternate combined source such as FDI, general government external borrowings (loans) and portfolio investments. Since acquisitions of claims or the incurrence of liabilities is very often subject to reversal, even in the short run.

Figure 5.7 Trends of Capital and Financial Account

Trends of capital and financial account against selected sources of financing scaled by GDP
FDI – foreign direct investment; GBN – general government borrowing net; short-term non-monetary net; CTB – capital transfers balance and CFAB – capital & financial account balance). PI = Portfolio investment.

It is imperative to always assess the reliability of these key financing sources especially, in situations where they are not feasible on a sustained basis. In circumstances like this, it may be prudent to consider a set of adjustment measures to achieve a viable external payments position for Ghana.

5.5 Direct Investments

In 2014, net inflows of foreign direct investments grew slightly by 4.5 percent to US\$3.4 billion (8.7 percent of GDP) after declining a little over 2 percent in 2013 (6.6 percent of GDP). This inflow primarily benefited oil related activities such as exploration and crude oil production in the Jubilee and TEN (Tweneboa-Enyenra-Ntomme) fields, and mining. Other sectors like telecommunication, financial and wholesale & retailing also attracted direct investment during 2014.

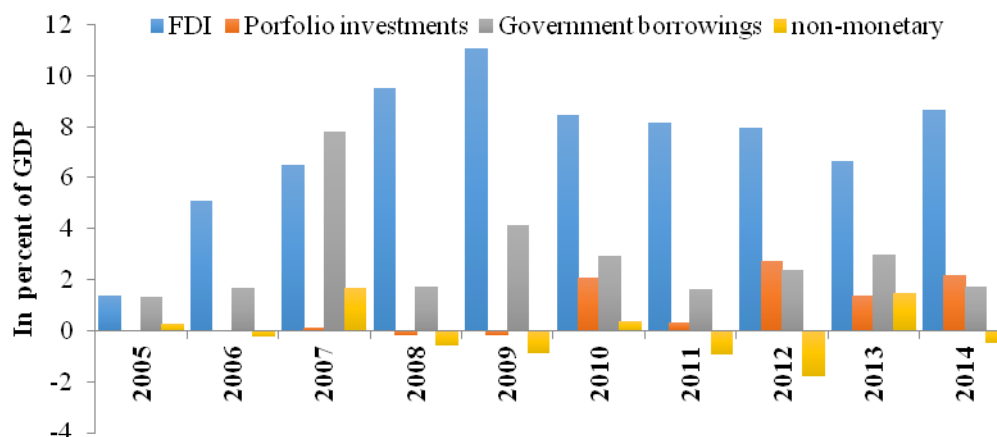
5.6 Portfolio Investments

Over the past eight (8) years, portfolio investments primarily in the form of debt securities of the likes of 3-year, 5-year and sovereign bonds had been issued by government as a means of financing the fiscal budgets for both re-current and capital

expenditures; often times patronised by non-resident investors particularly, in sovereign bonds issuance.

Figure 5.8 Foreign Direct Investment:

Trends in FDI, portfolio investment, government borrowings and non-monetary short-term capital flows



Participation also by domestic investors has been strong in the 3 and 5-year bonds. In 2014, net portfolio investment rose by US\$0.18 billion to a surplus of US\$0.84 billion (2.2 percent of GDP), in contrast with a reversal of US\$0.46 billion in 2013 from a surplus of US\$1.1 billion (2.7 percent of GDP) in 2012.

Other Investments

Other investment are those apart from direct and portfolio investments. There are compressed to the types broadly defined by medium and long-term net general government capital borrowings (in the form of loans) and short-term net capital flows of both public and private institutions.

Net general government external borrowings (loans) fell by US\$0.78 billion to US\$0.67 billion (1.7 percent of GDP) in 2014, this was reflected in loan disbursement short-fall, while repayments on loans increased by US\$0.16 billion to US\$0.48 billion (1.2 percent of GDP) as a result of rapid growth in net external liabilities including public debt.

Non-monetary short-term trade credits mainly linked to Ghana's Cocoa Board loan for purchase of cocoa, recorded net outflows of US\$0.40 billion in 2014, mainly due to the repayments of the previous year's loan compared with net inflows worth below US\$100 million in 2013.

These developments in the current, the capital and financial accounts during 2014, reflected an overall balance of payments deficit of US\$0.085 billion (0.2 percent of GDP), a significant improvement compared with a deficit of US\$0.87 billion (1.8 percent of GDP) recorded in 2013. The gross foreign assets⁴ decreased just by US\$0.17 billion to US\$5.5 billion in 2014 covering 3.2 months of imports.

⁴ Includes encumbered assets and Ghana's oil investments

6. INNOVATIONS IN GHANA'S PUBLIC FINANCIAL MANAGEMENT: 1980 – PRESENT

This chapter describes the evolution of Ghana's Public Financial Management (PFM) and the innovations towards improving the system. We examine the generation of policy reforms introduced since the World Bank's Structural Adjustment Program and Economic Recovery Programs of the mid-1980s to the current Ghana Integrated Financial Management Systems, and conclude that progress in PFM reforms have been uneven with a greater measure of success in financial legislation, revenue mobilisation and management, but less so in budget reforms and expenditure control. Systemic weaknesses remain in the budgetary process and they continue to weaken the implementation of legislative measures intended to improve overall PFM. Moreover, PFM reforms have failed to yield the necessary results relative to the level of effort and public investment that have gone into it over the years. Solutions can be found, much in government actions, in better coordinated efforts in planning, design, implementation and monitoring and the political will to enforce legislations in public financial administration.

6.1 Historical Review of Public Financial Management: 1980 – 1995

Ghana has since the mid 1980s and under various Development Partners (DP) funded programmes implemented various reforms towards the improvement of its Public Financial Management (PFM) system. Reforms intensified when the economic crisis of the late 1970s and early 1980s led to the introduction of the Structural Adjustment Programme (SAP)/Economic Recovery Program (ERP) in 1983. PFM reforms were part of the broader public sector reforms initiated in 1987.

Specific PFM Measures

The Economic Management Support Project of the SAP brought improvements in budgeting, auditing, expenditure reporting and tax administration. The reforms also saw for the first time the introduction of an Integrated Personnel and Payroll Database (IPPD) which enabled the automated processing of the public sector payroll and analysis of personnel information (PUFMARP News, 1999). Key reforms measures included the following:

- The introduction of the Commonwealth Secretariat Debt Recording and Management System (CSDRMS) in the Debt Management Division (DMD) of the Ministry of Finance, the Bank of Ghana (BoG), and the Controller and Accountant-General's Department (CAGD) for the management of the country's external debt.
- The introduction of the Automated System for Customs Database (ASYCUDA) to improve customs administration.
- The introduction of accounting standards and new legislations to improve financial reporting and supervision in the financial sector through the implementation of the World Bank's Financial Sector Adjustment Credit (FINSAC).

However, these reform efforts were of a piece-meal nature. In addition, they were not guided by the requirements of an integrated financial management system and therefore could not deliver the desired public financial management reform objectives⁵. Despite the initial shortcomings of the PFM reforms, the Government of Ghana (GoG) in the last two decades has pressed on with its reform agenda with the goals to consolidate earlier reform gains and also to address outstanding challenges.

6.2 PFM Reform Programmes Implementation: 1995 – 2014

It was widely acknowledged that one of the key areas requiring improvements under Ghana's PFM reforms is the continued fiscal dominance in macroeconomic management. With a track record of high fiscal deficits, a review of fiscal performance shows that the government has not been able to keep the budget under control. In particular, expenditure control has not been successful and vast improvements in PFM would be needed in order to facilitate the reduction in overall fiscal deficit over the medium term. To this end, the GoG has since the mid-1990s introduced specific PFM initiatives including the Public Financial Management Reform Programme, the Ghana Integrated Financial Management Information Systems (GIFMIS), and Human Resource Management Information System (HRMIS).

6.3 Public Financial Management Reform Programme (PUFMARP) I & II

PUFMARP was a 6-year multi-component GoG programme to strengthen PFM, as part of a wider transformation process in the public sector implemented under the banner of National Institutional Renewal Programme (NIRP). The fundamental objective of PUFMARP was to enhance the efficiency, accountability, and transparency of the financial management practices in the public sector. PUFMARP sought to address a number of specific challenges including: lack of strategic planning framework, weak compliance with financial regulations, the predominance of an incremental budget system, lack of budget ownership, lack of proper accounting, auditing, and reporting; ineffective public expenditure monitoring and control; lack of medium term outlook and broad based budgeting. And it would attempt to do so in two stages.

PUFMARP I (1996-2003) was the initial implementation step. According to the 2012 Public Expenditure Financial Accountability (PEFA) report, PUFMARP I was supported by fragmented donor system. When the programme ended in 2003, following a significant reduction in donor funds, the GoG pursued its PFM reforms under PUFMARP II with domestic financing.

⁵ PUFMARP News, 1999.

6.4 Major Changes to Ghana's PFM under PUFMARF

The implementation of PUFMARF brought the following improvements to the PFM system: (i) improved reporting on extra-budgetary expenditure, (ii) good and timely public access to key fiscal information, (iii) adherence to a fixed, coherent, and respected budget calendar, (iv) reduction of average debt collection ratios for tax arrears and regularity and timeliness in revenue transfers to the Consolidated Fund, (iv) increased comprehensiveness in reporting on the debt portfolio, (v) improved timeliness of in-year budget implementation reports and annual financial reports, and (vi) greater effectiveness of and timely external audit scrutiny.”⁶

Budget Planning and Preparation Reforms:

In terms of Budget Reforms, PUFMARF improved the strategic planning part of budgeting with the promulgation of the Financial Administration Act (FAA), 2003 (ACT 654) and the introduction of Medium Term Expenditure Framework (MTEF) budgeting process - activity-based budgeting. The latter was to replace the line-item and incremental budgeting process in all Ministries, Department and Agencies (MDAs). MTEF was intended to improve fiscal policy formulation and implementation⁷. It also sought to improve the budget preparation process with the introduction of a budget circular, soliciting stakeholder input into the budget process, the preparation of Citizen's Guide to the Budget (2007 and 2008) and the publication of the budget statement and estimates all as part of the annual budget preparation process⁸. In addition, MTEF introduced the implementation of composite budgets as part of the fiscal decentralization component, which aimed to show budgetary information for central and local expenditures in each district and region.

However by 2003, MTEF was faced with several implementation challenges, including (a) the lack of deeper and early involvement of Parliament and Stakeholders in the budget process to influence resource allocations, (b) that detailed activities in MDAs' budget documents were not strategically-focused, (c) there was weak strategic framework for MDAs' budget and (d) most of the medium-term budget forward estimates were unrealistic and arbitrarily set. The irony is that these fundamental weaknesses were identified relatively early on in the implementation process but were never satisfactorily addressed.⁹ As a result, they continued to undermine the implementation and therefore the intended benefits of the MTEF.

⁶ Ghana PEFA Report, 2009.

⁷ Ghana MTEF Handbook, 1999.

⁸ Betley et al, 2012; 30.

⁹ Betley et al, 2012; p: 51.

Financial Management and Information Systems (FMIS) Reforms:

A key component of the PUFMARP reforms was the introduction of the Budget Planning and Expenditure Management System (BPEMS) intended to automate budget preparation and execution for improved financial reporting and accounting. Its implementation, however, encountered technical design, managerial and infrastructural challenges. By the end of 2010, BPEMS was not fully operational in any of the 8 initial pilot MDAs, with parallel systems still being run alongside and as a result the project was scrapped. In fact, there were limited outputs to show for the investment undertaken under BPEMS estimated at around US\$ 22.5 million between 1997 and 2010.¹⁰

Payroll Data and Human Resource Management Reforms:

The implementation of Integrated Personnel Payroll Database (IPPD2) intended to improve payroll management was undermined by the persistent revelation of “ghost names” by external audit reports. This was evidenced in government’s commitment to clear about 1,157 apparent ghost names in the public education sector (2011 Budget Statement). The human resource management module however, was not implemented.

Revenue Management Reforms:

Major innovations introduced under PUFMARP were the introduction of specific systems and processes, such as a Tax Identification Numbering System, covering all types of tax and a new value added tax (VAT) regime. Revenue reforms focused on organizational restructuring to deliver on reform objectives, including:

- The establishment of Tax Policy Unit in the Ministry of Finance (MoF);
- The automation of operations in six Internal Revenue Services pilot offices and
- The establishment of the Ghana Revenue Authority (GRA) under the GRA Act 2009 (Act 791), as a unified organization, merging the three revenue agencies - the Customs, Excise and Preventive Service (CEPS), the Internal Revenue Service (IRS), the Value Added Tax Service (VATS) and the Revenue Agencies Governing Board (RAGB) Secretariat - into a single Authority for the administration of taxes and customs duties.

Internal and External Audit Reforms:

PUFMARP also established the Audit Service at the national government level and Internal Audit Units (IAUs) in each MDA and MMDA through the promulgation of the Audit Service Act (IAA) 2000 (Act 584) and the IAA Act 2003 (Act 658), respectively.

¹⁰ Betley et al, 2012; p: 49.

The audit reforms introduced the development of national audit standards, specification of audit reports, and value-for-money audits.

Public Procurement Reforms:

A key deliverable of the procurement reform was the enactment of the Public Procurement Act (PPA), 2003 (Act 663), which established the Public Procurement Authority, to harmonize public procurement processes in the public sector for enhanced judicious, economic and efficient use of public resources and to ensure fair, transparent and non-discriminatory procurement. However, there still remain some challenges with the procurement system. The 2009 PEFA Report notes that “while the legal and regulatory framework is clear on the controls for each of the main steps of the procurement and expenditure cycle, these are not applied uniformly across all MDAs. For example, a 2005 audit of selected flows found that there are no strict adherences to the application of expenditure controls.

Ghana Integrated Financial Management Information Systems (GIFMIS):

The Government of Ghana introduced the DP-supported GIFMIS Project in May 2009,¹¹ to address the challenges and failures of the BPEMS under the PUFMARP. GIFMIS is therefore a repackaged BPEMS introduced to enhance PFM through reliable financial reporting, informed decision making, and reliable planning for national growth and service delivery. The system is currently serving as the central budget implementation system for accounting and reporting. It is integrated with computerised systems at the Ministry of Finance, the Controller and Accountant-General’s Department, the Public Services Commission, the Ghana Revenue Authority, Bank of Ghana and the Public Procurement Authority. The summary of the state of implementation are as follows:

- ***Budget Planning and Preparation:*** The Budget Reform under the GIFMIS introduced the Programme Based Budgeting (PBB) system under the MTEF to replace the ABB approach at the central government, with the preparation of all MDAs’ budgets in PBB format in 2014, as part of efforts to address challenges of the MTEF. In addition, a new Budget Preparation and Management System - Oracle based software, is currently being used to prepare MDA budgets. The new budget system addresses the weaknesses in the old system (MS Access-based ACTIVATE Software) and is expected to effectively support the implementation of programme-based budgeting (Budget Reforms Unit, MOF, 2014).
- ***Human Resource Management Information System (HRMIS):*** Under the GIFMIS, there is a Human Resource Management Information System (HRMIS)

¹¹ The project was designed as Component 4 of the e-Ghana Project with a pooled fund of US\$60.26 Million from the World Bank (US\$28.44m), DFID of UK (US\$15.05m), European Commission (\$12.27m) and Danish International Development Agency DANIDA (\$4.50m)

component, to improve public sector payroll and human resource management. The HRMIS has been piloted in eight MDAs and is yet to be fully rolled out to all MDAs. Also, the MOF and the CAGD have conducted biometric registration of all public sector workers in an effort to address the issues of ghost names. There are several administrative measures however, being implemented to curb the issue of rising public sector payroll cost.

6.5 Legal and Regulatory Reforms

The outcomes of the budget process strongly depend on whether there are clear rules for formulating, executing and reporting on the annual budget, as well as a clear statement of medium-term fiscal policy objectives¹². The legal and regulatory framework for Ghana's PFM has improved tremendously over the past two decades with numerous legislations, though there remain some lapses.

The main PFM laws are the Financial Administration Act, 2003 (Act 654) supported by the Financial Administration Regulations for budget preparation, execution and management of public funds; the Internal Revenue Act, 2000 (Act 592), the Ghana Revenue Authority Act, 2009 (Act 791), the Non-Tax Revenue Management Act, and the Petroleum Revenue Management Act, 2011 (Act 815), for tax administration and revenue management; Public Procurement Act, 2003 (Act 663), Audit Service Act, 2000 (Act 584), and the Internal Audit Agency Act, 2003 (Act 658), for procurement, commitment and expenditure control; and the Local Government Act, 1993 (Act 462), the District Assemblies Common Fund Act (1993), and the Chieftaincy Act (2008), for management of local government functions and funds, as well as the banking and financial laws.

There are currently ongoing activities under the GIFMIS to review the legal framework especially for improved transparency and accountability, budget management and control. The Ministry of Finance is currently undertaking steps in collaboration with key stakeholders to enact a Financial Responsibility Law as emphasized in the 2015 Budget Statement and Economic Policy of Ghana (2015 Budget; p: 154).

6.6 Impact of PFM Reform

Overall, there has been mixed success with PFM reform efforts in Ghana. The most notable success has been the passing of legislations despite implementation challenges of these laws. The outcomes of PFM performance as a whole have been anchored on budgetary outcomes in the areas of fiscal performance, allocation of resources and, legal and institutional frameworks, for effective and efficient service delivery.

¹² Lienert and Fainboim (2010)

As we will see in the chapter to follow, fiscal performance has been mixed with government budgetary results exhibiting unstable overall fiscal balance. Improvements in the overall fiscal balance between 2008 and 2011 were on account of improvements in revenue performance as a result of the reforms in revenue administration. The high deficit however, has been associated more with the lack of expenditure controls than on the lack of revenue improvements.

The PFM Reforms over the period have not improved expenditure control, commitment control and cash management, leading to high unpredictability of funds, accrual of expenditure arrears and substantial delays in the release of funds. And as we shall see later in this volume, debt management practices still remain weak.

In effect, fiscal discipline is undermined by the lack of a systematic mechanism for monitoring fiscal risks from public entities and sub-national governments which pose a substantial risk through their impact on the budget (PEFA 2012). In addition, though the reforms established some elements for strategic allocation of resources, outcomes have consistently been hindered by the fragmented nature of the budget, making it difficult to conduct meaningful analysis of efficiency and effectiveness of public spending.

Despite the improvements in legal and regulatory framework, efficiency of service delivery has greatly been affected by wastage in the system and non-compliance with internal controls arising from fiscal indiscipline. Overpricing and excess expenditure on numerous unfinished government projects have not yielded any benefit to the Ghanaian public. As measured by the 2012 PEFA assessment criteria, unfavourable fiscal results have constantly accompanied Ghana's electoral cycle with negative influence on the consistent implementation of the PFM reform agenda. Fiscal discipline has deteriorated in each year prior to elections resulting in the build-up of arrears and a weakening of commitment controls and other internal controls.

With the completion of GIFMIS I, the Ministry of Finance has concluded an agreement with the World Bank and other development partners to acquire extended funding to kick-start the implementation of GIFMIS II by June 2015 (MOF Budget Reforms Unit, 2015). The extension of GIFMIS has been tied to the development of an overarching Public Financial Management (PFM) Reform Strategy.

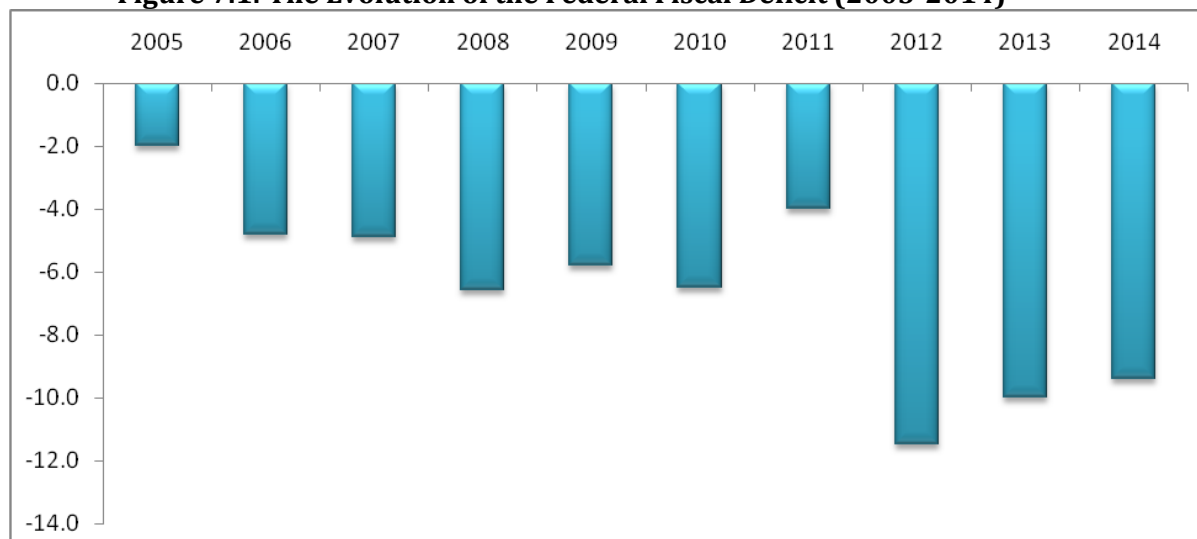
7. GHANA'S FISCAL PROBLEM: A DECADE OF REVENUE AND SPENDING TRENDS – (2005-2014)

7.1 Introduction

Implementation of Ghana's fiscal policies in the context of a broader macroeconomic framework has not been without setbacks in the last decade although, fiscal policy objectives over this period were generally in line with the overall macroeconomic goals of stability for accelerated growth and development. These setbacks have generally been attributed to the implementation of pro-cyclical fiscal policies during election years and in periods when the economy benefitted from buoyancy in tax revenues. As a result, the fiscal deficit has grown over the last decade, averaging about 6.5 percent of GDP compared with a sub-Saharan Africa average of 3 percent of GDP. Ghana's fiscal consolidation efforts has been largely unsustainable although there has been significant efforts to improve the fiscal performance in periods when the country was under an International Monetary Fund (IMF) supported programme, as in 2002-2005 and again in 2009-2012.

In the last decade alone, Ghana has on two separate occasions, sought for an IMF supported programme to enable it correct macroeconomic imbalances. A strategy to rein in the fiscal deficit featured prominently in each case. These efforts notwithstanding, the implementation of a number of comprehensive fiscal policy reforms (to increase efficiency in tax and expenditure administration and debt management), Ghana, is yet to experience the full benefit of all of these reforms. Continuing widening deviations between what the budget plans to achieve and the actual outturns persist, especially in key spending areas such as wages and salaries and recently, interest payments and subsidies. These not only illustrate difficulties in enforcing adherence to the budget planning but also perhaps reflect on the weak budget planning itself, its implementation as well as the systemic public financial management challenges. Figure 7.1 provides a record of fiscal deficits.

The deficit grew from 2.0 percent of GDP in 2005 to 6.6 percent in 2008. Contributing to the strong fiscal expansion during this period were high energy-related subsidies, increased infrastructure investment, higher wages and salaries, and a rise in social mitigation expenditures to dampen the effects of the global food price shocks [Ghana MEFP, 2009-12]. However, between 2009 and 2011, fiscal policy was driven by the goal to reduce the deficit and at the same time improve growth and rein in inflation pressures. The limited options to rapidly improve resource mobilization together with rigidities in expenditure patterns compelled the scaling back of non-statutory domestically financed capital expenditures.

Figure 7.1: The Evolution of the Federal Fiscal Deficit (2005-2014)

Source: Annual Budget and the IMF

There were also efforts to contain the growth in the wage bill, and reduce subsidies to utilities through tariff increases. As a result, the fiscal deficit declined from 5.8 percent of GDP in 2009 to 4 percent in 2011.¹³ Fiscal policy implementation suffered its worst performance at the end 2012 with the deficit widening to 11.5 percent of GDP on account of several factors including:

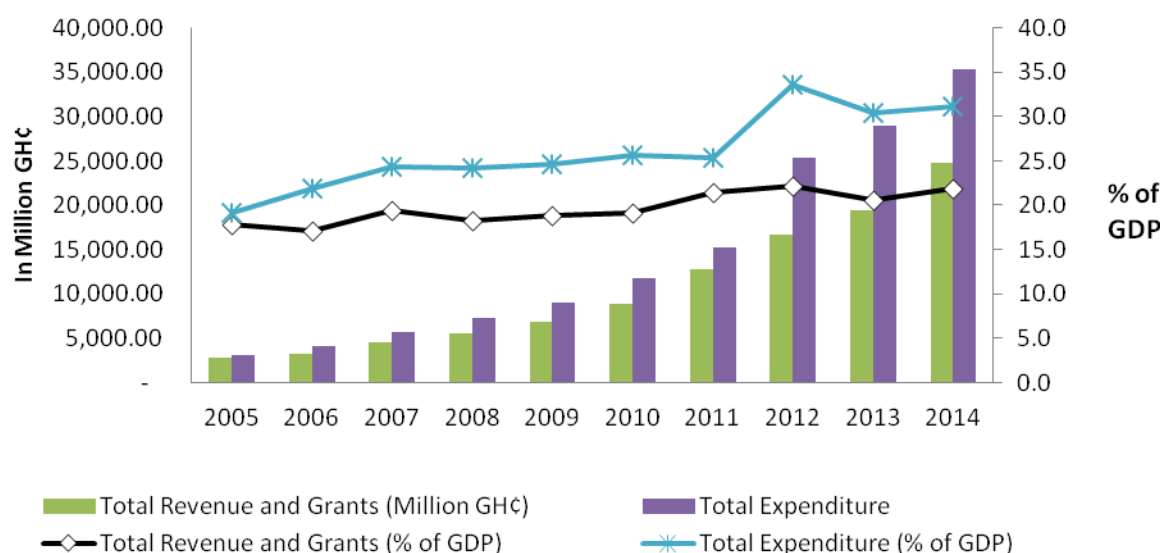
- a. implementation challenges associated with the single-spine wage policy initiated in 2007;
- b. shortfall in grants from Development Partners;
- c. non-realization of projected revenue from the oil companies, due mainly to shortfall in projected output in 2011 and 2012;
- d. larger-than expected petroleum and utility subsidies;
- e. higher interest costs arising from the steep rise in short term domestic interest rates from the round of bonds that were issued to fund the national budget; and
- f. the continued disruption in gas supply from the West African Gas Pipeline (WAGP) that led to a substantial increase in subsidies.

The fiscal deficit remained high in 2014 despite gradual fiscal consolidation efforts undertaken since mid-2013. The numerous tax and expenditure measures that were introduced to contain the fiscal deficit in 2013 and 2014 were undermined by policy slippages, increasing debt-service costs and external shocks. Despite higher oil revenues, improved tax collection and some containment of the wage bill, delays in implementing some measures and unbudgeted wage arrears payments resulted in a higher-than-budgeted cash fiscal deficit in 2014 of 9.4 percent of GDP, against a budget target of 8.5 percent.

¹³ It is important to note that, Ghana was under an IMF supported programme during this period. Soon after this period, Ghana entered an election year and suffered its worst ever fiscal performance over the period.

This deficit was against the backdrop of additional accumulated domestic arrears, in particular on social security contributions and statutory funds such as the District Assemblies Common Fund (DACF) and the Ghana Education Trust Fund (GETF). The growth of spending in the last decade has not been matched by growth in domestic tax revenues (Figure 7.2).

Figure 7.2 The Evolution of Expenditures and Receipts (2005-2014)



Source: Ministry of Finance and Author's own Calculations

7.2 Total Revenue and Expenditures

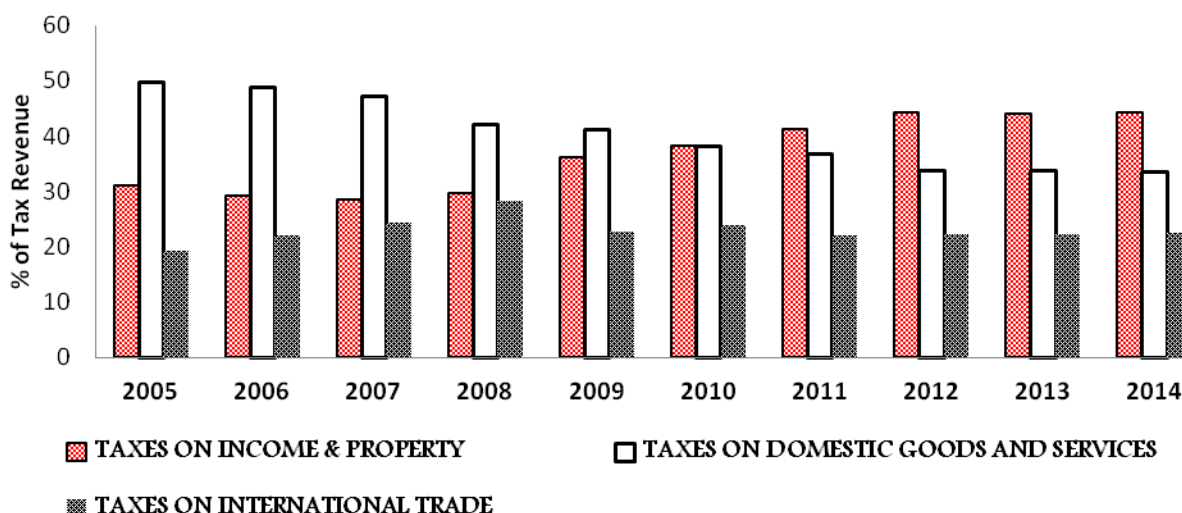
Total revenue including grants as a share of GDP increased from 17.8 percent of GDP in 2005 to around 21.8 percent of GDP in 2014, only lower than the 2012 level of 22.1 percent of GDP.

Over the period, the share of tax revenues to GDP grew from 13.5 percent of GDP in 2005 to 16.6 percent in 2012 before declining to 15.1 percent of GDP in 2013 on account of a slowdown in economic activity. Although tax revenue grew by 16.9 percent of GDP in 2014, excluding exemptions reduces the magnitude of growth by about 1 percent of GDP and this should ultimately be a growing concern as tax exemptions inflate the actual performance. Despite revenue growth, it is still below the average for middle income countries as well as the sub-regional average.

Currently, taxes on income and property is contributing more to tax revenues, overtaking taxes on goods and services which prior to 2010 made the highest contributor to tax revenues.

The growth in company taxes and the recent addition of corporate income taxes from oil explain the robust growth in taxes on income and property.

Figure 7.3 Evolution of Expenditures and Receipts (2005-2014)



Source: Ministry of Finance

Oil production begun in December, 2010. Total oil revenues as a percentage of domestic revenues increased from 5.7 percent in 2011 to 6.3 percent in 2012, to 8.7 percent in 2013 and to 12.3 percent in 2014.

Government expenditures have consistently been higher than revenues in the last decade. A situation which has prompted the introduction of a series of public financial and expenditure management reforms. However, relative to the significant funds expended on Public Finance Management (PFM) reforms over the period, the full benefits are yet to be achieved.

Total expenditure grew from 19.1 percent of GDP in 2005 to 31.9 percent of GDP in 2014. The major driver of public expenditures over this period was the Compensation of Employees of which wages and salaries contributed about 86 percent. The ballooning wage bill was exacerbated by the implementation of the Single Spine Pay Policy between 2009 and 2013 when public and civil servants were being migrated onto the new Pay Structure. The new pay policy sought to remove distortions in public sector wages and for that reason alone it was commendable. The implementation strategy, however, was poorly managed.

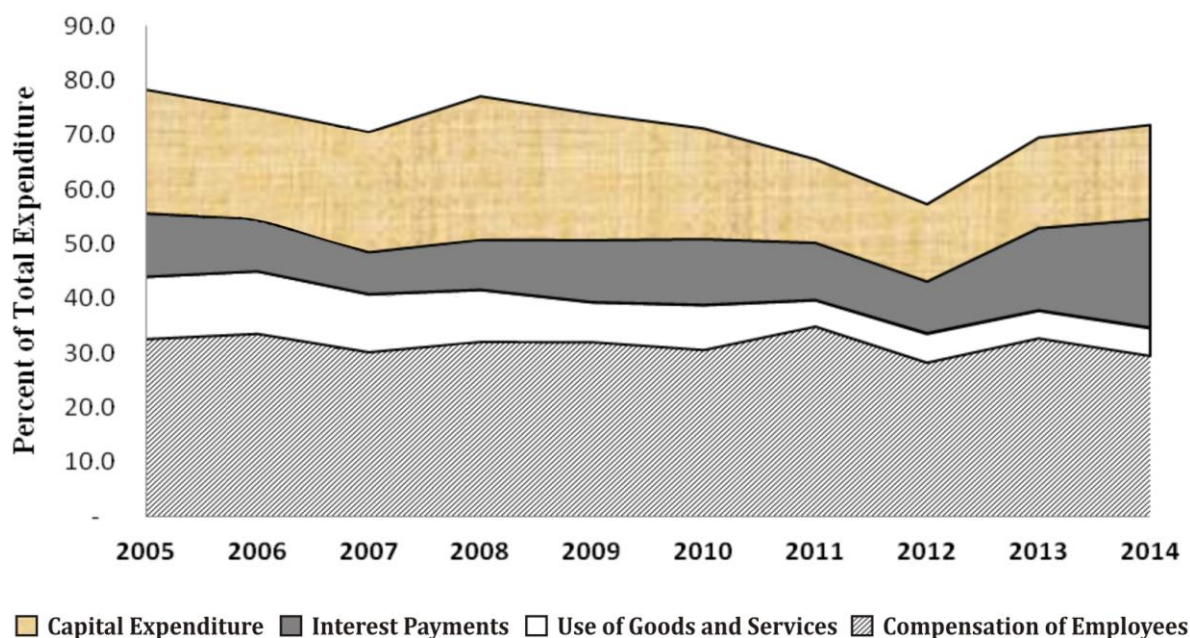
Table 7.1 Composition of Expenditures (2005-2014)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	in percent of GDP unless stated otherwise									
Total Expenditure ¹⁴	19.09	21.86	24.36	24.24	24.59	25.65	25.40	33.61	30.47	31.19
Compensation of Employees	6.23	7.35	7.37	7.78	7.89	7.86	8.87	9.53	9.98	9.23
o/w Wages and Salaries	5.21	6.08	6.13	6.59	6.77	6.91	7.58	8.85	8.68	8.33
Use of Goods and Services	2.16	2.49	2.56	2.29	1.78	2.09	1.21	1.76	1.53	1.57
Interest Payments	2.24	2.10	1.90	2.25	2.82	3.13	2.69	3.23	4.63	6.24
o/w Domestic	1.70	1.62	1.39	1.60	2.11	2.44	2.19	2.50	3.99	5.39
o/w Foreign	0.54	0.48	0.51	0.65	0.71	0.68	0.51	0.74	0.64	0.86
Subsidies	0.26	1.43	0.02	0.07	-	0.28	-	1.07	1.22	0.42
Grants to Other Government Units	2.44	2.05	3.93	3.73	2.67	3.95	4.19	5.00	4.79	4.28
Social Benefits	-	-	0.01	0.01	0.04	-	-	-	0.00	-
Other Expenditure	-	-	1.83	3.13	1.33	1.86	1.61	2.46	1.73	1.07
Capital Expenditure	4.32	4.40	5.35	6.36	5.69	5.19	3.88	4.76	5.05	5.37
o/w Domestic Financed	0.52	1.57	2.21	3.32	0.78	0.77	0.93	1.39	1.93	1.12

¹⁴ Total Expenditures have been calculated to include all arrears cleared as well as the discrepancy

Interest payments have also been rising in the last decade reflecting heavy borrowing by government to meet its rising deficit. For instance, one of the major causes of the huge fiscal slippage in 2012 was attributed to the payment of higher interest costs arising from the steep rise in short term domestic interest rates, from the round of bonds that were issued to fund the national budget. Overall, the percentage of interest payments to total expenditures has been increasing as indicated in Figure 7.4.

Figure 7.4 Composition of Total Expenditure



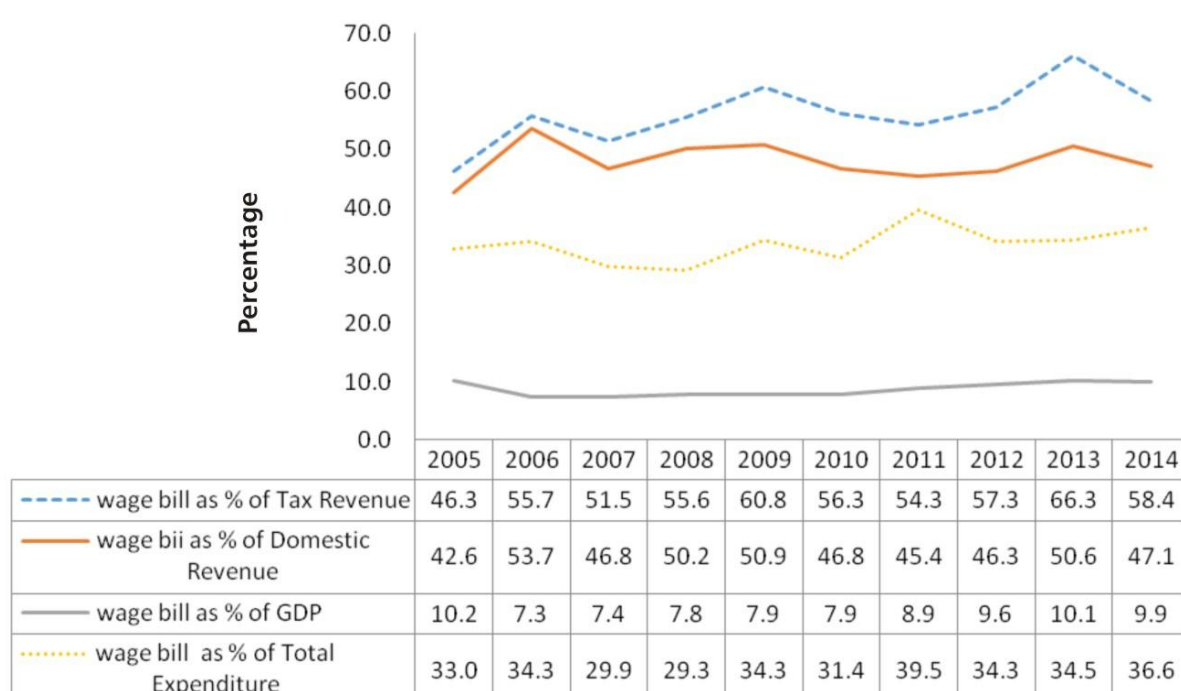
The composition of expenditures has not changed significantly since the introduction of petroleum revenues into the Budget through the Annual Budget Funding Amount (ABFA). Between 2011 and 2013, the ABFA amounted to GH¢1.4 billion and spending of petroleum funds was limited to the four priority areas set in the 2011 Budget Statement as required by the Petroleum Revenue Management Act (PRMA) Section 21(5). These include Roads and Other Infrastructure; Agriculture and Modernization; Capacity Building; as well as Expenditure and Amortization of Loans for Oil and Gas Infrastructure.

7.3 Is Spending becoming more Development or Consumption Oriented?

As stated earlier, Ghana's fiscal situation is one characterized by persistent budget deficits over the period 2005 to 2014. This has been largely driven by excessive expenditure over revenues. These expenditures have been predominantly recurrent, averaging 71.7 percent from 2005-2008 and 79.3 percent from 2009-2013. Within that same period, capital expenditures as a percentage of total expenditures, constituted 28.4 percent and 20.7 percent respectively. Consumption expenditure made up of wages and salaries, subsidies, transfers as well as goods and services have outpaced expenditures on capital outlays. This indicates that, while consumption expenditures are increasing over time, less and less resources are going into capital expenditure.

The rising trends in recurrent expenditures have been compounded by the upsurge in the public wage bill since the implementation of the single spine salary structure (SSSS). The wage bill as a percent of GDP has been on an upward trend since 2006 where it increased from 7.3 percent to 7.9 percent of GDP in 2010 and rising subsequently to 9.9 per cent of GDP in 2014. Consequently, the wage bill has absorbed a large chunk of Ghana's domestic resources (See chart 2.5). The escalating interest payments due to high borrowing have also contributed to the rising share of consumption expenditures over capital expenditures. For instance, interest payment as a percentage of total expenditure averaged 9.5 per cent from 2005-2008. This increased to 12.9 percent between 2009-2013. As percent of GDP the increase peaked in 2013 at 16 percent of GDP from 12.3 percent recorded in 2009.

Figure 7.5 Wage Bill as Percent of Revenue and Expenditure

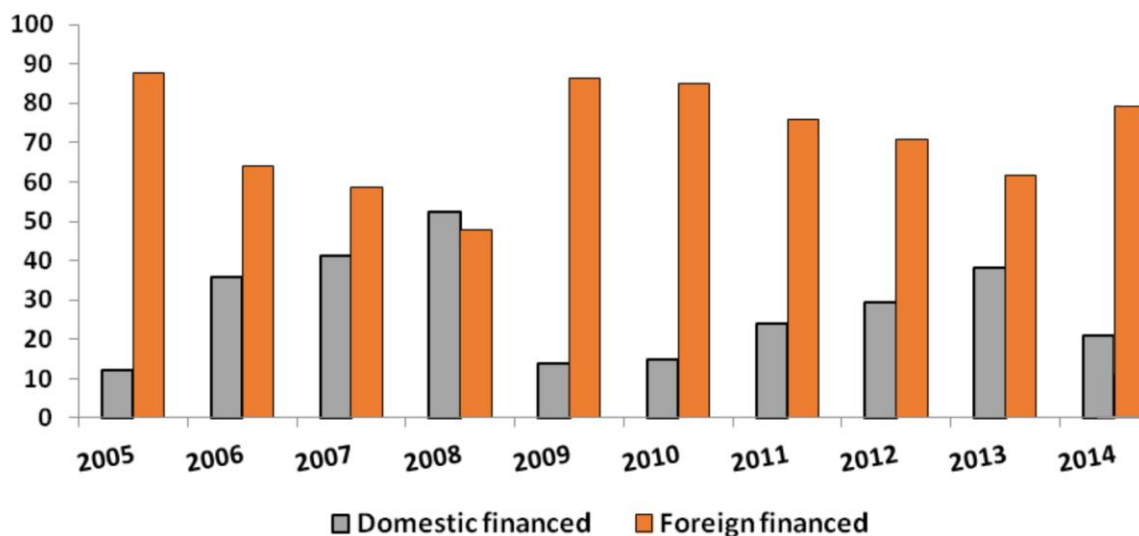


The budget for 2015 projects interest cost of 7.1 percent of GDP compared with proposed capital expenditure equivalent to 5.2 percent of GDP. This is an indication that going forward, outlays on consumption expenditures are expected to be over and above amounts to be spent on capital investments. Compensation of employees has been by far higher than amounts spent on development expenditure since 2005. However other items of consumption expenditure such as subsidies, transfers, payments of goods and services as well as other statutory payments have been somewhat erratic as in some years depending on government objective, they are seen to be above or below outlays on capital expenditure.

Clearly, spending is becoming more consumption oriented than capital oriented. This could be a worrisome development, as there remains a significant infrastructural gap ranging from transportation (road, rail, sea, and air), telecommunication and energy. Even more worrying is the fact that Ghana depends heavily on foreign financed capital

projects as shown in chart 2.6. This has a compounding effect because it increases debt-servicing charges and compounds the debt problem, especially at a period when Ghana as a low middle income country has limited access to concessional loans.

Figure 7.6 Percent of Domestic and Foreign Financed Capital Expenditure (2005-2014)



7.4 Is Ghana's fiscal problem the result of unrestrained spending, poor domestic revenue mobilization or poor public financial management?

In Ghana, domestic revenues have always lagged behind expenditures mainly as a result of poor revenue mobilization. Expenditures have also been high with very weak controls particularly on capital spending. Unproductive and overambitious projects, have ultimately worsened the deficits. A comparative analysis with West African Monetary Zone (WAMZ) countries shows that domestic revenue to GDP was only better than those recorded in Sierra Leone between 2006-2008. However, it performed better than Nigeria and Sierra Leone in 2009 and in 2010 it outpaced all the other peer countries. This good performance has been overtaken by Guinea since 2011 (See Table 7.2). Actual domestic revenues to GDP ratio in Ghana still remains below that of some of the countries in the West African Monetary Zone.

Total expenditures in proportion to GDP in 2005 was the highest amongst the WAMZ countries amounting to 30.7 percent and by 2012, Ghana had managed to outperform only The Gambia. Ghana has also consistently spent a huge amount of its domestic revenue it collects on debt servicing and an even greater percentage on paying wages and salaries as it consistently exceeds the threshold of 35 percent for compensation of employees in relation to tax revenues generated.

Table 7.2 Percent Domestic and Foreign Finance Capital Expenditures

Domestic Revenue to GDP	2005	2006	2007	2008	2009	2010	2011	2012	2013
Gambia	20.8	21.0	21.8	19.7	16.2	16.0	14.8	16.0	16.1
Ghana	23.8	13.7	14.8	15.9	15.5	16.8	19.5	21.2	20.0
Guinea	13.7	14.4	14.3	15.7	16.9	15.3	20.3	24.4	17.5
Nigeria	N/A	15.6	13.3	17.1	11.7	10.2	12.4	12.4	17.6
Sierra Leone	9.7	10.2	9.2	8.9	9.0	9.8	11.5	11.4	11.1
Total Expenditure and Lending to GDP	2005	2006	2007	2008	2009	2010	2011	2012	2013
Gambia	28.3	23.7	22.8	23.0	23.3	22.7	23.7	29.5	27.0
Ghana	30.7	20.7	24.3	26.5	22.5	25.0	22.5	28.6	28.0
Guinea	14.5	16.1	14.8	17.4	23.7	29.7	21.5	25.6	25.0
Nigeria	41.6	34.1	28.2	32.6	22.8	25.4	25.4	23.8	20.4
Sierra Leone	19.2	18.7	14.2	15.0	17.5	20.6	16.9	11.9	15.6

Source: WAMI

Weak public financial management systems in spite of significant reforms have also contributed to Ghana's fiscal problem. Although these reforms are backed by strong legislative base, there have been significant challenges in implementing the laws. Reforms probably have not been bold and comprehensive enough due to weak budgetary framework, ineffective audit as well as lack of reliable, accurate and timely information. Indeed a 2004 World Bank report observed that internal audits are generally weak, annual audits are frequently prepared in arrears and sanctions are not even carried out after these delayed audits.¹⁴

7.5 Pro-poor Expenditures

The IMF's effort to increase the effectiveness of the Heavily Indebted Poor Countries (HIPC) initiative in 2001 provided the Government with fiscal relief in return for a commitment to a set of measures and signaled the start of a series of intensified pro-poor expenditure programmes. In 2004, with the completion of the GPRS I agenda, the reduction in the Government's debt servicing commitments took some of the pressure off the budget. This situation set the agenda to enable expenditures related to poverty reduction increase.

The Ghana Shared Growth and Development Agenda I (GSGDA) guided the Government in implementing its economic and social policies, and thus also in allocating public expenditure.¹⁵ The latest progress report reveals that, although major social protection initiatives to address poverty and vulnerability have been implemented over the years,

¹⁴ See Public Expenditure Management Country Assessment and Action Plan (AAP) on Ghana, May 28, 2004.

¹⁵ The GSGDA was the economic development strategic framework for the period 2010-13. This framework succeeded the GPRS 2.

certain categories of Ghana's population are still affected by multiple vulnerabilities due to chronic poverty and the negative impact of certain macroeconomic and environmental factors and socio-cultural practices (ILO, 2014).

Table 7.3 Poverty Reduction Expenditures as outline in Annual Budget Statements

	2005	2006	2007	2008	2009	2010	2011	2012
Poverty reduction Expenditure (million GHC)	769.0	965.0	1,293.0	1,682.0	1,860.0	2,348.0	2,485.0	3,423.0
Poverty reduction Expenditure (% of GDP)	42.6	37.7	35.8	32.0	33.0	29.2	25.6	21.4

The trend in poverty related expenditures has been declining over the period. And this has fueled the debate about government's commitment to poverty reduction given the poverty reduction objectives set out in the GSGDA I which succeeded the GPRS II.

7.6 Conclusion

Ghana's fiscal challenges exhibit inherent structural weaknesses which tend to be exacerbated over electoral cycles. Given the role of public expenditures in financing Government's consumption and investment activities as well as the rising need for pro-poor services/expenditures, Ghana's fiscal woes may linger on for a while unless deliberate policies are put in place to end the emerging trend.

There is an urgent need to broaden the tax net given the implications of both domestic and external financing options on the economy. The current tax policy measures are inadequate to match the growing levels of spending. In view of this, taxes on natural resources especially, gold and oil must be reviewed as the economy can reap some gains from these sectors. Additionally, efficiency in tax collection must be improved with very little room for human intervention. Tax authorities must prosecute all offenders to serve as a deterrent to tax evasion.

Expenditures must be rationalized to minimize waste. The new pay policy must be reviewed together with stakeholders to ascertain its sustainability in the long term. The legal framework guiding all transfers to Statutory Funds must be reviewed to free fiscal space for other developmental expenditures. All subsidies must be eliminated due to the lack of proper targeting. And finally, interest cost from borrowing must be reduced as this serves as a huge fiscal risk over the medium term.

First, poverty related expenditures must be rationalized by establishing a comprehensive and consistent database containing all flows of funding into the poverty related intervention programmes. Secondly, the rules for the allocation of funds from the statutory funds to the poverty related intervention programmes should be clearly stated. The flow of funds varies from year to year and the political decisions that drive the allocations haven't been transparent. As a result, the programme planners never know what to expect and financial planning and management becomes more complicated.

8. GHANA'S RISING DEBT ISSUES

8.1 Introduction

Ghana has been running persistent budget deficits for most years since independence due to rising government expenditure and inadequate revenue generation capacity to pay for the spending.¹⁶ The rising expenditure is partly due to increased demand for infrastructure, high public sector wage bill, and high debt service payments. Shortfall in government revenue is often attributed to a narrow tax base, high rate of tax evasion and corruption in the revenue collection agencies.

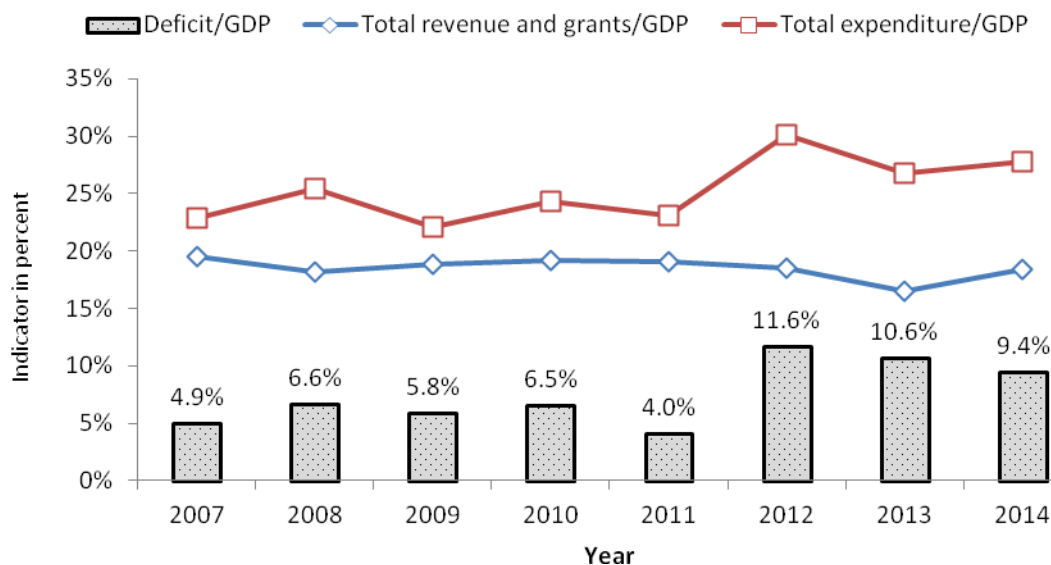
While the Government of Ghana (GoG) may run fiscal deficits in order to stimulate economic growth by building up enough capital stock, debt can be issued to cover fiscal deficits and repaid in the future.¹⁷ Persistent deficits, however, means that the debt level and its servicing will continue to grow. Unconstrained borrowing may lead to explosion of the levels of public debt due to higher interest payments with the result that large and costly fiscal adjustments must be made in future to restore budget balance. This chapter examines the recent trend in borrowing from both domestic and external sources and its implications for debt sustainability in Ghana.

8.2 Decade of Deficits and Borrowing

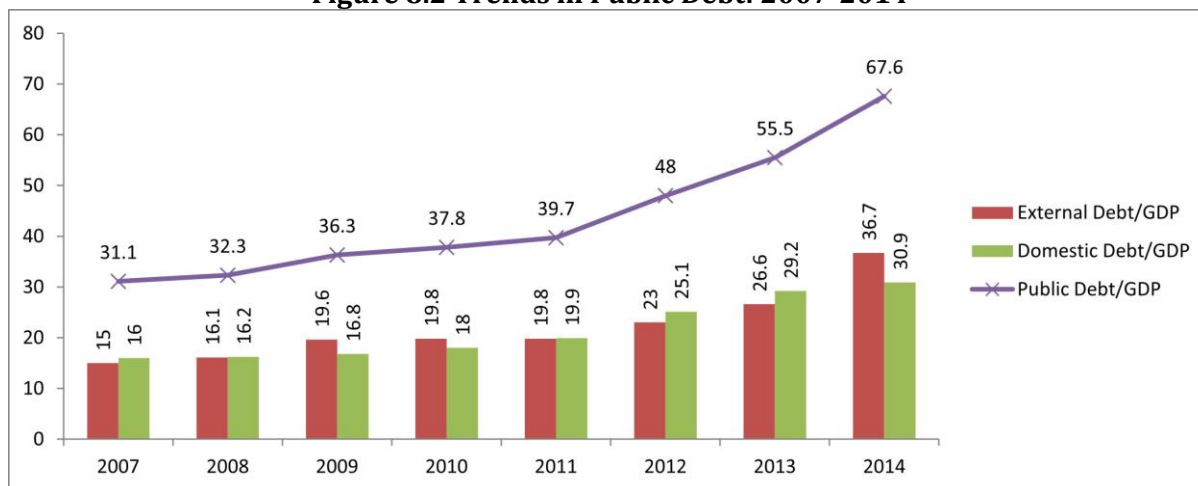
Government succeeded in reducing its debt stock between 2000 and 2006 under the World Bank/IMF sponsored Highly Indebted Poor Countries (HIPC) program and the Multilateral Debt Relief Initiative (MDRI). Generous debt relief under HIPC and MDRI reduced public debt stock substantially. Between 2003 and 2013, government enjoyed debt relief to the tune of US\$2.9 billion. This saving was used to support Ghana Poverty Reduction Program (GPRS I), Growth and Poverty Reduction Strategy (GPRS II) and Ghana Shared Growth and Development Agenda (GSGDA). This initiative freed up additional resources for post-completion point HIPC countries. Ghana also received debt relief under MDRI to the tune of about \$832.79 million in financing the GPRS II (2005-2008) and the GSGDA (2009-2012). These debt reduction initiatives created fiscal and borrowing spaces, which have been exploited by government in recent years. Low level of post HIPC/MDRI public debt was seen by politicians as an invitation to add to the public debt stock. In addition, Ghana Statistical Service (GSS) release of the new Gross Domestic Product (GDP) series in retrospect as part of the rebasing of the national accounts revised upwards the GDP numbers, indicating an improved capacity of government to meet its debt service obligation. The two factors partly explain government borrowing exuberance in post-HIPC/MDRI.

¹⁶ See Amoako-Tuffour (1999, 2001)

¹⁷ Xiomara and Greenridge, 2003.

Figure 8.1 Expenditures, Revenues and Budget Deficits (2007-2014)

Source: Ministry of Finance and International Monetary Fund

Figure 8.2 Trends in Public Debt: 2007-2014

Source: Ministry of Finance and International Monetary Fund

Noticeably, revenue performance in the past decade as a fraction of national output (GDP) has been fairly stable around 20%. At the same time, expenditure pressures through wage demands and expenditure on pressing developmental needs have been rising, especially in the run up to the 2012 elections, pushing the size of government from about 22 percent in 2007 sharply to 30 percent in 2012. It is not surprising then that GoG had been running overall budget deficits with the confidence that the expenditure-revenue gap could be bridged through borrowing from domestic and/or external sources. The persistent revenue-expenditure gap has resulted in rapid accumulation of debt as a way of financing the budget deficits.

Borrowing has traditionally been dominated by multilateral and bilateral creditors, who provide funds on concessional terms.¹⁸ In diversifying its financing sources, government made its maiden international capital market borrowing in 2007 issuing a Eurobond of US\$750 Million for infrastructural development. There have been subsequent issues of Eurobond facilities of US\$1 billion in 2013 and 2014, the proceeds of which according to the government were used for infrastructural development, counterpart funding and refinancing of maturing short-term domestic debt. Equally significant borrowing from other commercial sources has been undertaken to develop oil and gas infrastructure since 2010.

Non-concessional loan facilities have been procured from the BRIC (Brazil, Russia, India and China) countries, particularly the Peoples Republic of China and Brazil. The conditions and terms of the loans facilities secured from China¹⁹ and Brazil are considered expensive with high interest rates, shorter repayment terms and other conditions including selling oil at prevailing market prices to these countries, all of which are likely to put a heavy debt burden on the GoG in the near future. Drying up of traditional borrowing sources and the resort to commercial borrowing has, however, raised sustainability questions. Ghana is not likely to receive any generous debt relief as has been done in the past. Its current lower middle income status may not allow this to happen. Meanwhile, Government envisages more domestic and non-concessional borrowing in the medium term (MOFEP, 2011) as part of its strategy to replace high interest maturing short-term domestic debt with external debt of longer maturities.

8.3 The Debt Service Challenge and Debt Sustainability

Increasing Cost of Financing

There is a limit on levels of public debt that governments can afford to take on and still remain solvent. The debt to GDP ratio (simply debt/GDP) considered optimal and that should not be breached on a long term basis is estimated at about 60 percent for developed countries and 40 percent for developing and emerging economies.²⁰ As a lower middle income country, Ghana's debt sustainability is presently under threat because its debt/GDP ratio of 67.6 percent as at December, 2014 exceeds the benchmark of 40 percent of GDP for emerging countries. Some developed countries such as Australia and the United Kingdom have as part of their fiscal rules set a benchmark of debt/GDP ratio not exceeding 40%. It is believed that setting such a benchmark well below the debt threshold provides the fiscal space to absorb shocks to the economy without breaching the medium term public debt target. It is even suggested that Ghana should have, as its benchmark, a debt to GDP ratio of not exceeding 30 percent in order to ensure its fiscal sustainability, revising the ratio

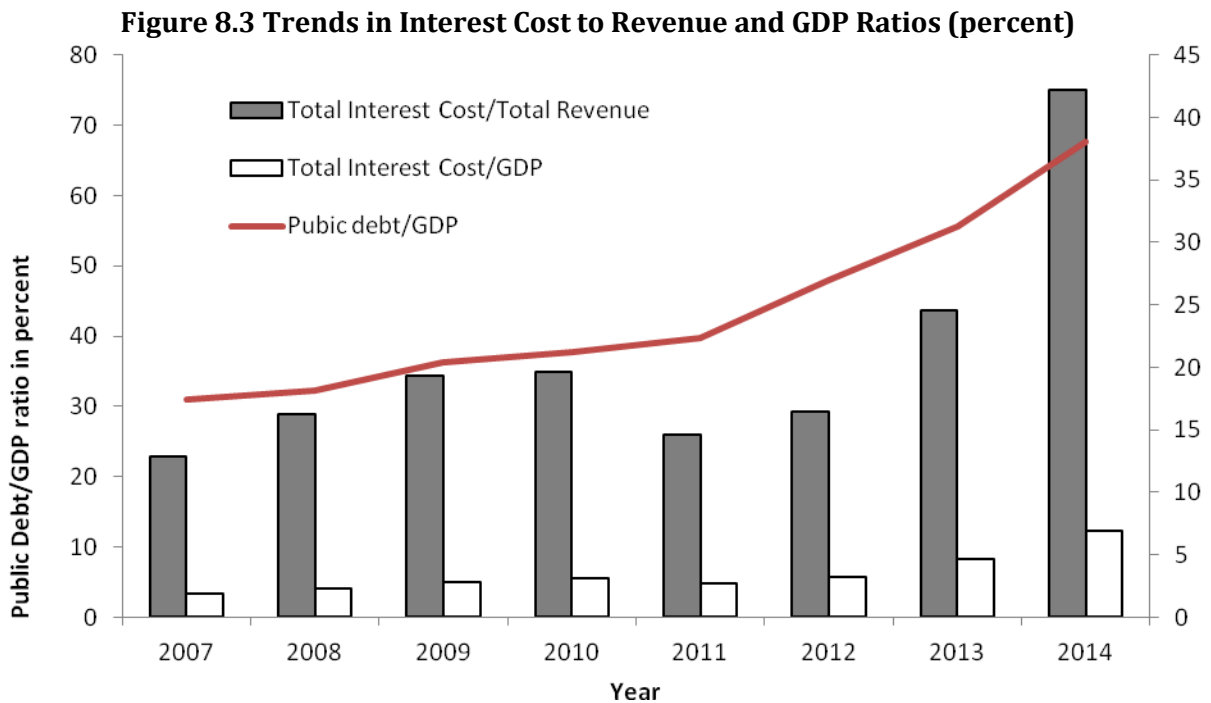
¹⁸ For the history of public debt in Ghana see Amoako-Tuffour, 2001.

¹⁹ See this links for details: <http://www.the-american-times.com/3-billion-loan-terms-chinese-development-bank-government-ghana/2014/03/25> and <http://www.mofep.gov.gh/?q=reports/cdb-loan-summary-050112>

²⁰ Debrun and Kinda, 2013.

upward as the economy grows and also safeguarding the economy against threats of external shocks including commodity price collapse and exchange rate volatility.

Generally, rising interest payments on debt crowd-out the provision of public goods and services over time. That is, there is an opportunity cost to interest payment because it diverts taxpayers' money from spending on other areas of public interest; and it is worse, if the debt is issued to fund primary spending (expenditure of goods and services except interest payments).



Source: Ministry of Finance

According to Debrun and Kinda (2013), interest payments above 12 percent of government revenue for advanced economies and 26 percent for emerging economies will likely have adverse effects on the primary budget balance, creating an additional need to borrow. Countries with a larger interest bill are expected to run higher primary surpluses so that high and rising debt service will not raise the risks of default or debt restructuring. Excessive debt burden could trigger a very aggressive pace of fiscal adjustment/consolidation in the near future which may be welfare-reducing through its distortionary effects on labour markets and saving decisions. A low interest bill, despite rising debt stocks, may encourage a more gradual fiscal consolidation path which does not disrupt economic activities. Moreover, it is estimated that for most emerging economies, interest payment above 5 percent of GDP is likely to spark financial crises. For Ghana, the continuous rise in the level of domestic borrowing at high interest rates to finance the budget over the years account for the strong growth in interest payments to creditors.

In Ghana, interest payments have been rising at a rapid pace since 2007 (Figure 8.3). As a percentage of total domestic revenue, interest payments increased from 13 percent in 2007 to a high of about 42 percent in 2014, which exceeds the recommended threshold of 26%. Similarly, interest payments as percentage of GDP also increased from about 2 percent in 2007 to about 7 percent in 2014, again exceeding the recommended 5 percent threshold for emerging economies. Over the years, interest cost has been dominated by domestic interest payments. The high interest cost is attributable to high domestic interest rates itself fueled by inflationary pressures, the high rollover and refinancing risks associated with the domestic debt portfolio. About 32 percent of the debt portfolio has maturities of less than 1 year, implying that government would have to rollover existing domestic maturing debt at a higher interest rate. Another source of external debt service burden is the weakening of the value of the local currency against the borrowing currency, US dollar. Ghana's debt portfolio is highly exposed to the US dollar. About 75 percent of the total external debt service is made in US dollars, making it susceptible to fluctuation in the exchange rate.

Is Ghana Risking Debt Sustainability?

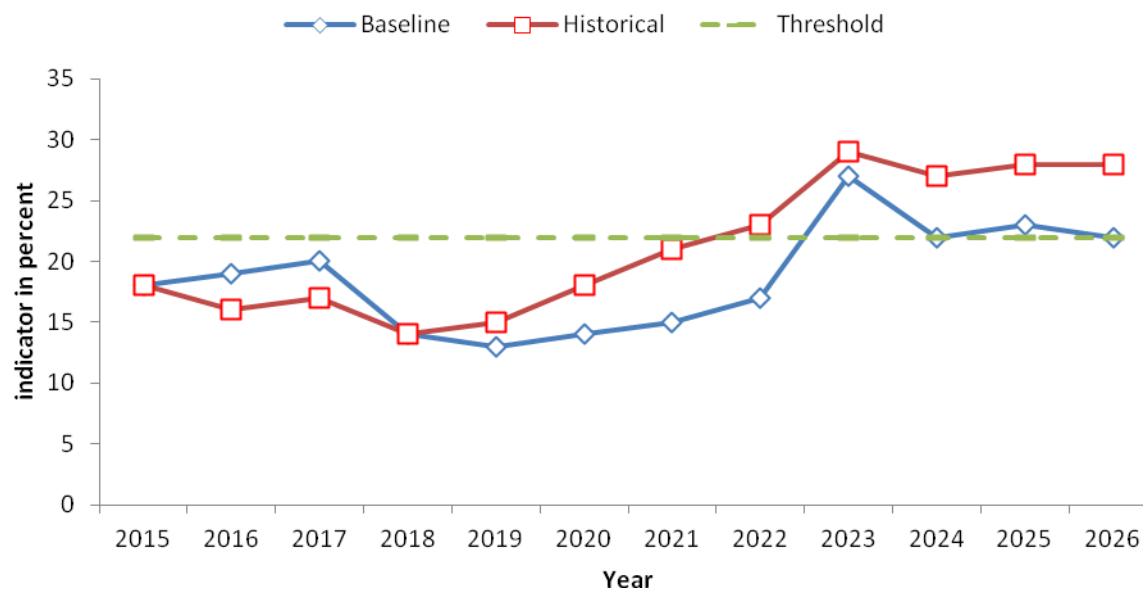
Debt sustainability can be analyzed from two perspectives: fiscal and external debt sustainability. Fiscal solvency (fiscal sustainability) requires that the present value of primary budget balances should be at least equal to the initial public debt. That is, if a government is initially running primary deficits, it needs to run primary budget surpluses over the medium term to remain solvent. A country could run very large primary deficits for a while if it could credibly commit to run primary surpluses in the long run to satisfy the condition that the discounted value of primary balances is at least equal to the initial public debt. However, it is difficult for governments to credibly commit to fiscal adjustment path. In addition, running primary surplus means raising taxes or cutting expenditure in the long run to compensate for short run primary deficits. Raising marginal and average tax rates may be very large and distort economic choices (labour, saving behaviour) in ways that could hurt long run growth. Cutting government spending and public service provision may again be difficult because of entrenched interests.

The same argument holds for foreign debt. It may not be realistic and feasible to run large trade surpluses in the long run to finance persistent excessive trade deficits in the short run. The exchange rate and domestic income adjustment to contract imports and expand exports may be excessive if a country runs a trade deficit in that case.

Sustainability of public debt is assessed under three scenarios: Baseline, historical and the extreme. Under the baseline scenario (the most likely scenario), it is assumed the government will carry out fiscal consolidation as planned in its economic policy statements which is expected to maximize revenue mobilization, improve efficiency of spending and narrow budget deficits. The historical scenario (shock to the baseline)

assumes that growth rates and fiscal deficits in the future are expected to follow the past trends and government will continue to pursue policies similar to those implemented over the past ten years. Under the extreme scenario (extreme shock), it is assumed that there will one-time 30 percent depreciation in 2015, capturing the phenomenon of exchange rate volatility in recent years.

Figure 8.4 External Debt Sustainability using Debt Service to Domestic Revenue Ratio



In this study, debt service to revenue²¹ ratio is used to examine the external debt sustainability while fiscal sustainability is assessed using Present Value (PV) of Debt to GDP. Under the baseline scenario, Ghana is expected to undertake fiscal consolidation as promised in the budget statement and other policy documents. Debt service to domestic revenue ratio is expected to remain below the indicative threshold of 25 percent throughout the projection period, except a temporary breach in 2023 and 2024 when the bullet repayment of the Eurobond facilities is expected to be met (Figure 8.4). Running these historically high deficits and the extreme scenarios (30 percent depreciation of the cedi in 2015), the debt service to domestic revenue ratios will breach the indicative threshold in 2023 and remain above the threshold for the rest of the projection period (Figure 8.4).

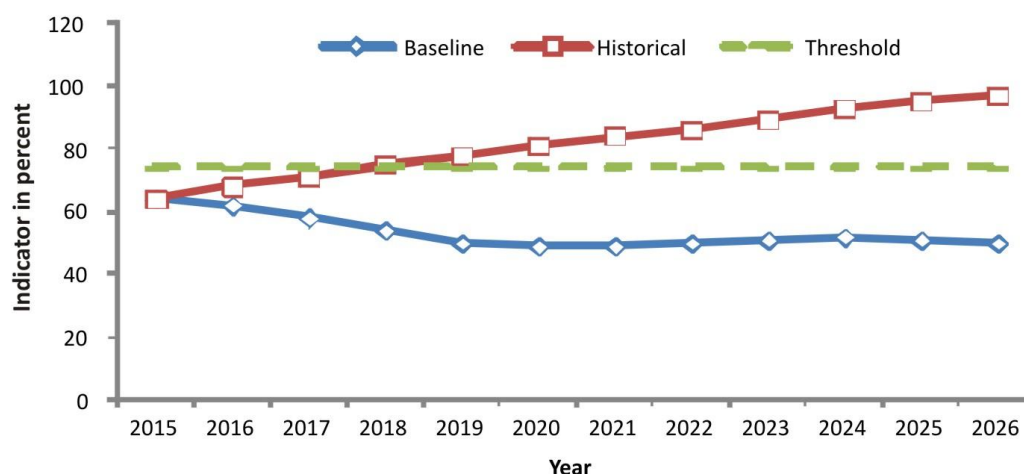
In terms of fiscal debt sustainability, the PV of debt to GDP is expected to remain within the indicative threshold of 74 percent throughout the projection period under the baseline scenario (Figure 4.5). The PV of debt to GDP, however, would breach the benchmark of 74 percent under the historical and the extreme scenarios. In a nutshell, both external and total public debt face high risk of debt distress, meaning if the current borrowing trend continues and GoG is not able to put measures in place to bring down

²¹ This includes tax and non-tax revenue including grants from Donors

the levels of public debt, government will sooner than later start defaulting on its debt service obligations to its external creditors.

8.4 Options for the Short-Term and the Medium-Term

Figure 8.5 Fiscal Sustainability Using Present Value of Debt to GDP Ratio



Attaining debt sustainability requires fiscal commitment from government. First, government needs to quicken the pace of domestic debt restructuring away from short-term to medium and long term instruments, a practice which seems to have slowed down in recent years. Second, since we know too well that commercial borrowing is more expensive, government should be very strategic in what to use the funds from commercial sources for. In fact, the end use must be clearly identified in order to generate future stream of revenue to finance the initial borrowing. Third, finding cheaper financing sources is undoubtedly crucial. Warmer relations with donors and official creditors can help to obtain favourable financing terms including grants from this category of development partners at least in the short to medium term.

Fourth, at the institutional level, government should consider enacting a debt management law which will give a clear mandate to the Debt Management Division to carry out their functions. As it stands now, the work of debt managers is governed by fragments of enabling acts including the Loans Act of 1970, Financial Administration Act, Financial Administration Regulation and relevant articles in the 1992 Constitution of Ghana. A Fiscal Responsibility Law is premised on the fact that fiscal deficits drive debt accumulation in many developing countries. This law will restrain government from overspending and incurring high budget deficits. Government may also consider establishing a Debt Management Office (DMO) to be housed outside the Ministry of Finance in the medium to long term. An independent DMO will attract skilled personnel dedicated to the advancement of debt management objectives. And finally, Government needs to grow the economy in order to ensure debt sustainability. High growth rates will not only reduce debt levels, it will also enhance the capacity of government to repay its debt.

8.5 Conclusion

Persistent fiscal deficits more often than not result in debt accumulation. Government has reverted to its old ways of borrowing excessively after benefitting from generous debt relief under HIPC/MDRI. This time round, borrowing from commercial sources on non-concessional terms, as a result of the drying up of traditional borrowing sources, has, however, raised sustainability questions. Ghana does not only have a high level of public debt, its debt burden in terms of interest payments is beyond recommended thresholds for emerging economies. Debt service to revenue ratio also reveals that external debt sustainability is threatened as Ghana faces a high risk of debt distress. The present value of total public debt to GDP also indicates that Ghana is a high risk in terms of fiscal debt sustainability.

Debt sustainability requires considerable commitment from government. Options available to government include quickening the pace of domestic debt restructuring, creating a culture of warmer relations with donors and official creditors can help to obtain favorable financing terms including grants from this category of development partners; enacting a debt management and fiscal responsibility laws will improve fiscal discipline, reduce debt accumulation and clarify the role of the debt manager. Government may also consider establishing an independent debt management office to be housed outside the ministry of Finance in the medium to long term, equipped with requisite human resource to the advancement of debt management objectives.

9. IMPROVING FISCAL MANAGEMENT IN GHANA: THE ROLE OF FISCAL POLICY RULES

This chapter examines the role of fiscal policy rules in promoting fiscal discipline and transparency in Ghana. It investigates whether the adoption of fiscal policy rules and independent fiscal policy councils can help improve fiscal performance, drawing on international evidence.²²

9.1 Ghana's Need for Rules in Fiscal Management

Perhaps, the single most important factor that could derail Ghana's ability to advance to high middle income status is weak fiscal governance. Except for a few years at the turn of the millennium, fiscal management in Ghana has been consistently weak. Poor revenue collection built upon a narrow tax base and low tax compliance have combined with seemingly uncontrollable expenditure pressures particularly in election years. This unsatisfactory fiscal governance culture has been at the centre of a vicious cycle of persistent deficits and continuous public sector borrowing and has contributed to high interest rates, excessive pressure on the exchange rate, distorted cost of capital which crowd out private investment and nurture overall economic uncertainty for businesses and households alike in ways that inhibit long-term planning and deter the kind of investments that promote growth and job creation.

Breaking the circle of inconsistent fiscal management clearly requires a balance between market pressure and fiscal rules in order to keep public finances on a sustainable path. But the evidence is that the quality of market signals alone is by itself an insufficient indicator to accurately guide the conduct of fiscal policy especially in periods of crisis. There is therefore the need for fiscal governance measures which embed a credible improvement in fiscal responsibility and permanently constrain fiscal deficits, except for well-defined special circumstances. For businesses and households, fiscal consolidation in Ghana needs to be credible in order to anchor market expectations about fiscal sustainability. *Weak fiscal governance threatens macroeconomic stability*

9.2 The Background

Ghana has a track record of high fiscal deficits (Chapter 3), partly reflecting procyclical fiscal policies in good times and electoral cycles. A review of fiscal performance in Ghana over the past two decades shows that the country has not been able to keep the government budget under control. For instance, the average fiscal deficit for Ghana between 2005 and 2013 was 7½ percent of GDP compared with just 3 percent of GDP

²² This chapter is based on paper prepared for the Institute of Economic Affairs by Dr. Charles Amo-Yartey, the Resident Representative of the International Monetary Fund (IMF) in Liberia, on how to use fiscal policy rules to improve fiscal management in Ghana.

for sub-Saharan Africa. Fiscal performance in Ghana tends to worsen during election years with the attendant increase in debt levels.

Over the years, revenue performance has improved significantly while at the same time primary spending has strongly increased. Between 1990 and 2013, total revenue as a share of GDP increased from 9 percent of GDP to around 18 percent of GDP though still below the average for middle income countries. At the same time, primary spending has consistently been higher than revenues with spending particularly higher during election periods. For instance, both the 1992 and 1996 elections resulted in higher fiscal deficits in the 1990s and the same pattern was observed in the period between 2000 and 2012. Government, concerned about securing the support of public service labour unions, granted substantial wage increases in election years and embarked on ambitious capital projects many of them unproductive.

The public sector payroll is now the biggest component of government spending. It accounts for an average 9 percent of GDP and its share of GDP has grown significantly since 2010. Public wage growth outstripped real GDP growth over the past 10 years. Analyzing the real growth of expenditures on public wages and salaries together with real GDP growth shows that overall, the growth of real expenditure on public wages has been higher than real GDP growth during the past 10 years (graph of real public wages versus real GDP growth- equivalent to Public Wages/GDP growth). On the positive side, in periods of low GDP growth, wage growth has been particularly low. Additionally, in periods immediately after wage hikes, wage growth decelerated. For example, in 2005 and 2009, public wage growth fell significantly and was below the growth rate of real GDP.

9.3 Why Fiscal Consolidation?

Addressing Ghana's macroeconomic challenges requires an ambitious fiscal consolidation strategy. The fiscal deficit is currently very high and public debt is rising even though it is still within the range considered sustainable. It is important to note, however, that the debt trajectory is as important as the debt level in terms of influencing investor confidence and economic growth. A huge debt build up tends to undermine investor confidence and could limit growth even in situations where debt levels are low.

International experience suggests that there are two ways of fiscal consolidation: expenditure-based consolidation and tax or revenue-based consolidation and they are not mutually exclusive. The most appropriate route depends on the initial conditions of growth and economic balance. For Ghana, there is no easy option to take because the need to reduce the budget deficit comes in a difficult environment of weak growth and an uneasy political environment. Based on a survey of country experiences, expenditure-based consolidations with a focus on reducing current spending tend to be more successful than tax-based consolidation. However, since the adjustment need in Ghana is large, fiscal consolidation needs to be a balanced combination of spending cuts and revenue increases.

And for completeness, there should also be a rule-based fiscal policy to lock in the gains of fiscal consolidation and enhance policy credibility. *Countries find fiscal rules useful for instilling fiscal discipline and for undertaking large adjustments.*

9.4 Fiscal Policy Rules

Worldwide, several governments have adopted fiscal policy rules, especially against the backdrop of worsening fiscal performances and rising debt levels. There is evidence to suggest that fiscal rules have positive and strong impact on budget balances. Reforms of fiscal institutions and the introduction of fiscal rules are motivated by the objective, similar to those in monetary policy, that rule-based policies are likely to deliver better results. The objective of adopting a fiscal rule is to strengthen fiscal solvency and sustainability, contribute to macroeconomic stabilization, and make fiscal policy design and execution more resilient to government corruption and private sector lobbies. Fiscal policy rules could be defined as a permanent constraint on fiscal policy through simple numerical limits on budgetary aggregates. This definition implies two things: first, boundaries are set for fiscal policy, which is difficult to change frequently, and second, some operational guidance is provided by specifying a numerical target that limits a particular budgetary target.

Fiscal rules are normally aimed at correcting distorted incentives and containing pressures to overspend, particularly in good times, so as to ensure fiscal responsibility and debt sustainability. The literature has put forward two reasons that often account for the fiscal deficit bias—government's short-sightedness and the common pool problem because special interest groups do not take into consideration the overall budgetary impact of their competing demands. In many countries, the existence of many competing interest groups usually results in the "voracity effect", where different groups compete and push for overspending especially in good times leaving little or no room for counter cyclical policies in bad times. To solve these problems, a number of fiscal institutions including fiscal rules and medium term budget frameworks have been established around the world over the past three decades with a view to supporting more prudent and balanced fiscal policies.

Another justification for the implementation of numerical fiscal rules is to prevent policy makers from worsening macroeconomic volatility through procyclical fiscal policies. More specifically, there is a widespread consensus on the impact of fiscal rules that restrict government expenditure. According to the European Commission, enforced national expenditure rules help to counteract forces leading to pro-cyclical fiscal policy in good times and thus prevent the need for fiscal austerity measures in difficult times.

9.5 Going Forward for Ghana

Statistical analysis using data from 160 countries over nearly a span of four decades²³ make three important observations. First, fiscal policy rules are statistically associated with better fiscal performance. Second, countries that often experience a large debt reduction were more likely to have fiscal rules and were on average able to achieve a higher GDP growth and larger primary surpluses than countries that did not experience a large debt reduction. Third, fiscal rules tend to increase the probability of a large debt reduction because they help strengthen the fiscal framework and improve fiscal transparency.

Which types of fiscal rules are more successful in debt reduction? Worldwide evidence suggests that (a) debt and budget balance rules are important in explaining the probability of a large debt reduction; and (b) revenue and expenditure based fiscal rules do not appear to have any significant impact on the probability of a large debt reduction.

The adoption of debt and budget balance rules in Ghana will enhance fiscal credibility. A cursory look at the Ghanaian fiscal framework suggests existing fiscal rules are insufficient to improve fiscal discipline. There is therefore the need to implement a fiscal rule that has broad coverage of the budget more generally and further reduce discretionary policy interpretations.

Fiscal rules require supporting institutions and reforms. Fiscal rules tend to be most effective when they incorporate the entire public sector and are enacted by law or incorporated in the Constitution. Effective fiscal rules are also expected to include well defined sanctions if the rules are broken and clearly defined correction mechanisms. International experiences suggest that fiscal rules do not function in isolation and require supporting institutions and reforms to deliver the anticipated outcomes.

Key reforms to make fiscal rules effective in Ghana include:

- the establishment of an independent fiscal policy council;
- strengthening budget preparation and implementation;
- enhancing revenue forecasts;
- improving monitoring and enforcement procedures; and
- making legislative changes to make the fiscal rule legally binding.

Strengthening the precision of revenue forecasts and the sanctions regime are important in establishing a credible fiscal rule. Projections of available resources in the next fiscal year are needed earlier in the budget preparation process to determine realistic expenditure ceilings. An automatic correction mechanism can control for ex-post deviations from the fiscal rules. Strengthening enforcement procedures, such as sanctions for breaches of budgetary procedures and expenditure controls, will also be needed to encourage ex-ante compliance with the rules. Strengthening the sanctions regime will need to be addressed in legislation.

²³ The analysis uses a panel data of 160 countries for eight five year periods to estimate the probability that a large debt reduction would be initiated in each five year period. The dependent variable is the probability of a large debt reduction. The variable takes the value of 1 if a large debt reduction occurs and 0 otherwise. We define a large debt reduction as occurring when the debt to GDP ratio declines by at least 15 percentage points over a 5 year period. The explanatory variables are measures of fiscal rules, macroeconomic variables, political and institutional variables, and fiscal consolidation.

A fiscal policy council would enhance the quality of budget discussions and foster greater transparency. Independent fiscal policy councils can play the same role as monetary policy committees, deciding on deficits and the evolution of public debt. In Ghana, an independent fiscal council could have a key role in assessing the reliability of the macroeconomic and revenue assumptions underpinning the budget, and estimating the fiscal impact of proposed measures. In some countries, fiscal councils also play a “watchdog” role by monitoring compliance with fiscal rules. In addition, forecasts produced by fiscal councils can serve as a neutral baseline to assess the fiscal cost and macroeconomic impact of policy proposals. The mandate of fiscal councils in a few countries even allows for direct influence over the budget by specifying technical inputs, such as the macroeconomic and budgetary forecasts. *To be effective, fiscal policy councils need to be given a clear mandate, debt sustainability, so that they are freed from the time inconsistency problem that leads to a deficit bias.*

In addition to fiscal rules, strengthening fiscal performance in Ghana will require gaining control over the wage bill. Efforts should be devoted to ensuring a clean payroll system in the country. In addition, the wage setting process needs to be reviewed with a possible shift towards multi-year agreements that would be negotiated before the budget is finalized. Collaboration with labour unions would be critical in this regard.

The incorporation of these recommendations into Ghana’s present fiscal framework will help in the achievement of fiscal target and aid in the correction of fiscal loopholes that have proven so costly to the performance of the broader economy.

10. EFFECTIVE PUBLIC FINANCIAL MANAGEMENT IN GHANA: THE ROLE OF PARLIAMENT AND THE AUDITOR GENERAL

10.1 Introduction

This chapter turns to the role of Parliament and the Auditor General in ensuring effective public financial management. Despite their clear constitutional mandates, these institutions have been largely ineffective in their various mandates partly because of their lack of capacity and partly because of excessive executive control in the management of public finances. Ghana's experience shows that the mere existence of a formalized process of parliamentary scrutiny of public finances does not guarantee efficient and accountable use of public resources.

Many sub-Saharan African countries have over the past two decades undertaken Public Financial Management (PFM) reforms, with most of the initiatives driven by the need to embark on structural economic adjustments to attain debt relief. The reforms have sought to introduce new public financial management approaches, emphasizing the efficient mobilization and utilization of scarce financial resources. Recently, PFM reforms have also been an integral part of broad macro-fiscal reform support programmes to least developed economies.

As discussed in detail in Chapter One, Ghana has implemented PFM reforms for well over three decades with mixed results. The persistence of weak public financial management in Ghana continues to pose a challenge to the implementation of a credible multi-year fiscal planning and budgeting programme. Poor fiscal discipline due to inefficiency in budget execution and by extension service delivery across all Metropolitan, Municipal and District Assemblies (MMDAs) has been identified as one of the key binding constraints to effective Public Financial Management in Ghana. The Auditor General's reports have consistently highlighted non-compliance with internal control systems across state institutions, especially in the utilization of public funds which impacts service delivery through potential waste of scarce national resources.

The weak PFM framework in Ghana has in part manifested itself in the rising perception of corruption in the administration of public finances. The President of Ghana in his 2015 State of the Nation Address acknowledged corruption as a "canker that continues to plague our society."²⁴ This perception is further supported by recent press publications uncovering significant levels of perceived corruption, embezzlement and the misappropriation of public funds. Recent mechanisms of corruption include the

²⁴ See details; State of the Nation Address, 26th February, 2015, by his Excellency John Dramani Mahama, President of Ghana.

abuse of the judgement debt procedures, the approval of loans for the financing of big infrastructure projects and the disposal of state assets.

Ghana's weak PFM systems is reinforced by the country's relatively poor rating internationally on the issue of corruption. According to Transparency International's Corruption Perception Index Ghana ranks 61 out of 175 nations assessed in 2014. There is generally low credibility of the national budget document approved by Parliament. The lack of budget credibility is supported by the persistence of fiscal slippages from poor budget planning and implementation, which signal a significant challenge to Public Financial Management in Ghana.

The legislature, especially the Public Accounts Committee of Parliament, and the Ghana Audit Service (represented by the Auditor General) are two critical bodies whose work significantly contribute towards achieving improved PFM. An effective PFM system is essential for the implementation of sound macroeconomic policies; acts as the sounding board for the attainment of the country's developmental goals; ensures effective control of budget estimates; and helps to manage the fiscal risks of the budget. In addition, it ensures that the planning and execution of the budget are in line with stated government priorities. Poor PFM in Ghana highlights the overall lack of effective checks and balances as well as accountability of how government spends.

This chapter broadly reviews a key function of Parliament as a critical institution in ensuring effective Public Financial Management, by looking at Public Audit and how Parliament engages with this process.

10.2 The Legislature and National Audit

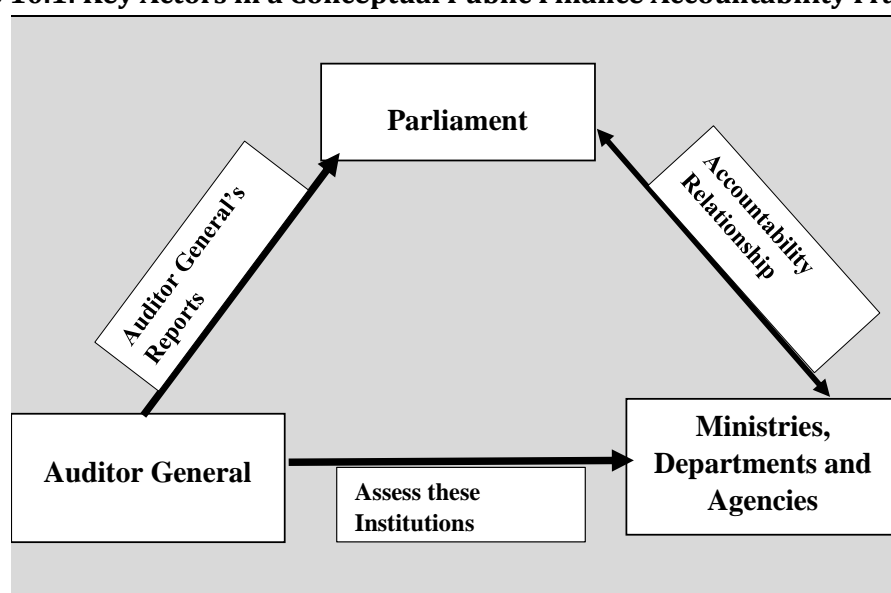
The rise of modern democratic governance has been defined by the struggle over parliamentary participation in PFM.²⁵ We have witnessed in recent years, in some developing and transition countries, a number of national legislatures moving towards "budgetary activism".²⁶ This development is on account of an increasing push for democratic and constitutional governance especially across the African continent. The creation of a national legislature, as a central feature in modern democratic governance systems, has opened up the possibilities for this crucial institution to actively participate in public financial management in otherwise closed economies. These developments have opened up the possibility of strengthening governance structures in these countries to ensure good financial governance.

²⁵ See Harris, G. L. (1975) *King, Parliament, and Public Finance in Medieval England to 1369*. Oxford (Clarendon Press), Reid, G. (1966) *The Politics of Financial Control: The Role of the House of Commons*, London (Hutchinson University Library).

²⁶ Posner, P., and Park, C-K. (2007) "Role of the Legislature in the Budget Process: Recent Trends and Innovations," *OECD Journal on Budgeting*, Vol. 7 No. 3 (Paris: OECD).

Parliament's active engagement in budget decision-making and overall public finance activities has led to a shift towards holding the executive to account for the ex-post performance of national budgets. The legislature and public audit institutions play a critical role in ensuring financial accountability. To this end good linkages of the audit process and Parliament, through its relevant sub-committees is critical.²⁷

Figure 10.1: Key Actors in a Conceptual Public Finance Accountability Framework



In most democratic jurisdictions, the legislature and the Auditor General have a constitutional mandate to ensure accountability for the use of public resources as well undertake investigations on specific issues which affect financial accountability within their jurisdiction. Figure 10.1 provides a simple framework and clearly highlights the interconnectedness between the role of the Parliament of Ghana and the Auditor General in ensuring effective public financial management. Parliament assesses the spending of all Ministries, Departments and Agencies (MMDAs) and holds them accountable through the Auditor General, who assesses these institutions and provides a detailed public audit report to Parliament (i.e. the Public Accounts Committee).

The Parliament of Ghana is legally required to review government spending to ensure aggregate fiscal discipline, resources are allocated in conformity with policy objectives outlined by the executive and in an operationally efficient manner. Parliament does so by relying on the work done independently by the Auditor General. However the call for effective legislative engagement in PFM is often not fully appreciated.

²⁷ SIGMA (2002) Relations between Supreme Audit Institutions and Parliamentary Committees. Paris, Organisation for Economic Co-operation and Development.

It is therefore important to briefly highlight some of the key arguments which have been put forward to support the relevance of both the legislature and National Audit institution in public financial management.

Parliament and the Control of the National Purse

Constitutional provisions in different legal jurisdictions do vest the legislature with the 'power of the purse' (i.e. the control of the legislature over public spending) which is widely regarded as a fundamental democratic principle.²⁸ Articles 174 – 182 of the 1992 Constitution of the Republic of Ghana clearly discusses in detail the relevance of the legislature in the management of public finances including the power to impose taxes, approve withdrawals from the Consolidated and Contingency Funds, and by extension the approval of the national budget. When Parliament fails this constitutional mandate of ensuring the effective utilization of the national purse, legislative control of the national purse is by extension severely compromised.

Parliament an Agent of Good Governance by Ensuring Checks and Balances

The exercise of unmitigated executive power, as evident during the periods of mainly undemocratic military rule in Africa has been proven to coincide with relatively poor governance.²⁹ The legislature through the principle of checks and balances in a democratic dispensation acts as an agent of good governance and ensures the Executive is answerable to Parliament. Through public audits, parliamentary scrutiny ensures the effective utilization of scarce resources and where wrong doings are identified, appropriate action is taken. In jurisdictions where there is a general lack of behavioural incentives to ensure that managers of an economy act with high integrity and where electoral accountability is weak, the lack of meaningful legislative checks and balances creates opportunities for waste and corruption leading to poor budget outcomes.³⁰

The Legislature: Enhancing Openness and Transparency in Fiscal Policy

The formulation of fiscal policy by the executive arm is often without widespread public consultation. For instance in Ghana, it is only when the budget is formally tabled in Parliament that critical public discourse becomes a reality. Parliament therefore provides an important platform for an open and critical discussion of national issues relating to public financial management.

²⁸ Wehner, J. (2004) Back from the Sidelines? Redefining the contribution of legislatures to the budget cycle. The World Bank Institute: Working Papers (28615).

²⁹ Owoye, O., and Bissessar, N. (2014) Corruption in African Countries: a Symptom of Leadership and Institutional Failure. In: Mudacumura, G., and Morcol, G.(eds). Challenges to Democratic Governance in Developing Countries. Springer International Publishing. pp 227 – 245.

³⁰ Burnell, P. (2001) Financial Indiscipline in Zambia's Third Republic: The Role of Parliamentary Scrutiny, Journal of Legislative Studies Vol. 7 No. 3:34-64.

The Complimentary Role of the Auditor-General in Legislative Financial Scrutiny

In some democratic dispensations, there exists an Auditor-General charged with the responsibility of auditing and reporting on all public accounts. In Ghana the Constitution makes provision for the creation of the office of an Auditor-General with the responsibility of auditing all public accounts of all public offices.³¹ In certain jurisdictions, legislatures do not exercise any significant influence on budget policy, and simply rubberstamp the Executive's draft budgets without any significant changes.³² The role of the Auditor-General becomes even more critical in such jurisdictions where the legislature's engagement and ability to influence fiscal policy decisions and public expenditure is limited to rubber-stamping proposals submitted by the Executive, as is the case in Ghana. Under such conditions, Public Audit and parliamentary scrutiny provide an independent assurance that, public funds are being efficiently deployed and in a transparent manner consistent with laid down procedures. Parliament scrutinizes government spending by reviewing the public audit reports submitted to it by the Auditor General.

10.3 Challenges of public financial audits in Ghana

The Audit Service of Ghana, headed by the Auditor General is the supreme audit institution established under the 1992 constitution of the Republic of Ghana (i.e. Article 187) and the Audit Service Act 2000, Act 584. Among other responsibilities, the Auditor General is required to audit and report on the public accounts of Ghana and of all public offices, including the courts, the central and local government administrations, of the universities and public institutions operating or funded with public funds, or any public corporation or other body or organisation established by an Act of Parliament. The legal provisions establishing this office, mandates the Auditor General to complete and submit its audit reports to Parliament within six months of the end of the immediately preceding financial year.

In its most recent public audit of Ghana's Public Accounts, the Auditor General highlighted several irregularities which led it to conclude that there were continued infractions and financial indiscipline on the part of MMDAs in acknowledging and observing legislative supremacy.³³ The 2013 Auditor General's report argues that these irregularities represent either losses that have been made by the nation through the impropriety or lack of probity in the actions and decisions of public officers or, on the other hand, the savings that could have been made, if public officials and public

³¹ See full details in Clause 187 of the 1992 Constitution of Ghana.

³² Wehner, J. (2004) Back from the Sidelines? Redefining the contribution of legislatures to the budget cycle. The World Bank Institute: Working Papers (28615).

³³ Ghana Audit Service (2004). Report of The Auditor-General on The Public Accounts of Ghana; Ministries, Departments And other Agencies (MDAs) For The Year Ended 31 December 2013.

institutions had duly observed the public financial management framework put in place to guide their conduct and also safeguard national assets and resources. In monetary terms the reports estimate that these irregularities has led to the State losing about GH¢477,708,455.81, which represents a 20.72% increase compared to the 2012 estimate of GH¢395,718,552.01, clearly signifying a worsening of PFM in Ghana.

The office of the Auditor General continues to face significant challenges in the performance of its critical national duties. These challenges including the following:

- General lack of manpower to support the work of the Ghana Audit service, resulting in delays in the submission of audit reports to parliament;
- The lack of adequate financial support has been identified by the Auditor General as a key constraint in the execution of its mandate;
- The lack of enforceability of audit findings after parliamentary review and recommendations; and
- Potential political interference and lack of neutrality is also perceived to hamper the smooth operations of the Auditor General's Department.

10.4 Challenges of the Public Accounts Committee of Parliament

The final output of the Auditor General's work, i.e. all public audit reports must be submitted to Parliament for scrutiny and further recommendations. The Committee responsible for the review of public audits submitted for parliamentary scrutiny in fulfilment of its responsibility of the "power of the purse" is the Public Accounts Committee (PAC). The 1992 Constitution grants Parliament extensive financial management responsibilities as outlined in Articles 174 – 184. The PAC like all other Committees of Parliament derives its authority and functions from the following legal provisions:

- Article 103 of the 1992 Constitution of the Republic of Ghana;
- PAC was established by Order 151(2) of the Standing Orders of the Parliament of Ghana;
- The functions of PAC are captured under Standing Order 165(2) of the Parliament of Ghana; and
- The Committee, according to Order 165(1), must consist of not more than 25 Members and under the chairmanship of a member who does not belong to the party which controls the Executive branch of government.

In 2007 there was a major shift in the PAC's manner of conducting business when it opened its doors to the public during its meetings/hearings. After the review of public audit reports, issues which are unsatisfactorily addressed together with recommendations on them are tabled for consideration and adoption by the entire House. The Committee's Report which after parliamentary adoption becomes the recommendations of the House, is then forwarded to the respective MMDA's for

implementation and, this more importantly, also constitutes feedback to these institutions. In principle, the Attorney General is at this point invited to commence prosecution of criminal cases referred to that Office following the adoption of the PAC report by Parliament.

The PAC is faced with challenges which threaten to both undermine and render its work ineffective. Some of these challenges include:

- The inability of PAC to effectively monitor and ensure its reports and recommendations are effectively addressed by MMDAs;
- The narrow mandate of PAC which limits its role invariably to carrying out historical audit reviews and PAC's inability to be very proactive to limit potential financial malfeasance; and
- Inadequate human capital to improve parliamentary oversight of public finance;
- Internal parliamentary bottlenecks in tabling audit reports for review and referral to PAC due to political considerations especially during election years.

10.5 Conclusion

The effective participation of Ghana's legislature in public financial management is essential if it should act as possible checks and balances, while enhancing openness which facilitates effective public debate. Despite the existence of such a structured accountability framework, what we have currently in Ghana by way of parliamentary financial scrutiny is one which has been emptied of much of its meaning with very little action coming out of the exercise of such role by the legislature.

Parliament's challenge in exercising its responsibilities is often evident especially when it comes to the control and scrutiny of public funds. Parliament routinely approves government's fiscal programme often in the form proposed, with "minimal fuss", riding on the back of government's majority in Parliament. In a situation where the Public Accounts Committee does its work, there is very little follow up on recommendations thereof. Parliamentary oversight is key in effective PFM. The strengthening of Parliament especially the Public Accounts Committee and the Auditor General's Department will help in addressing persistent weaknesses and promote discipline, transparency and accountability in Ghana's PFM. Ultimately, an increased engagement of Ghana's legislature can make a significantly positive contribution towards effective public financial management.

11: LESSONS FOR PUBLIC FINANCIAL MANAGEMENT REFORMS

Public Financial Management (PFM) is concerned with the management of the collection and utilization of public funds. Limited resources require all governments both developed and developing to mobilize and use public resources as efficiently as possible with limited waste. Efficient PFM systems are therefore central to the achievement of such a goal. The Government of Ghana (GoG) has since 1987 attempted a number of reforms aimed at strengthening its PFM systems. Notable amongst the reforms are the enactment of financial legislations, the introduction of budgeting, debt management, auditing and procurement systems as well as developing databases to handle budgeting, accounting, personnel and payroll functions. Some level of success has been achieved in the areas of financial legislation and revenue management. Overall, however, according to the World Bank Public Expenditure and Financial Accountability (PEFA) reports, reforms have not yielded the desired results relative to the significant funds that have gone into such reforms over the years (PEFA, 2012).

Building on the discussion of PFM reforms in the opening chapter, this chapter highlights the challenges that have limited the success of PFM reforms in Ghana and draws on the experiences of other countries to provide recommendations for ensuring the success of the next generation of PFM reforms.

11.1 Overview of Key Public Financial Management Reforms

Financial legislation reform has been given prominence in the set of PFM reform actions. The 2010 World Bank External Review of Public Financial Management (ERPFM) and subsequent PEFA reports confirm that the legislations provide a well grounded and formulated legal and regulatory framework for PFM. The financial legislations are the Financial Administration Act (FAA, 2003), Financial Administration Regulations (FAR, 2004), Public Procurement Act (2003), Audit Service Act (2000), the Internal Audit Agency Act (2003), Internal Revenue Act (2000) and the Ghana Revenue Authority Act (2009). And according to most experts, these legislations contain the right elements to foster a well regulated PFM framework and failure can only be attributed to contextual circumstances and the political economy. There have been challenges in the enforcement of the provisions of the FAA (2003) and FAR (2004) in expenditure management, resulting in constant annual disclaimers by the Auditor General on the audited financial statements of ministries, department and agencies (MDA). So much so that the 2010 ERPFM underscored the need for uniform compliance with the dictates of the various financial management acts and regulations.

Procurement

Ghana's procurement systems were revamped with the legislation of the Public Procurement Act (Act 663) by Parliament in 2003. The Act established the principles of open and competitive tendering for works, goods and services by all public bodies. The Act further provided for the establishment of a regulatory body, the Public Procurement Authority (PPA), with the responsibility of issuing the rules and regulations as well as overseeing the implementation of procurement activities of all public entities. The years following the promulgation of the law have witnessed the establishment of the PPA, the modernization of regulations governing procurement practices including the development of the Public Procurement Model of Excellence (PPME) and the bringing of all public bodies under the Act. However a number of challenges have been encountered hindering the effective implementation of reforms. The 2007 National Procurement Assessment Report revealed challenges such as the general lack of procurement professionals in most entities thereby resulting in understaffed procurement departments; the lack of interest by entities in who carries out procurement activities in their organizations; few entities with established complaints and appeals mechanisms; and the lack of understanding of procurement laws among staff in MDAs and Metropolitan, Municipal and District Assemblies (MMDAs).

Auditing

With regards to auditing functions, the country's internal audit process was overhauled in 2003 with the passage of the Internal Audit Agency (IAA) Act. The Act provided the tools and guidelines to co-coordinate, facilitate and provide quality assurance for internal audit activities within MDAs and MMDAs. By 2011 all but two ministries, 125 out of 149 Departments and Agencies, and 155 out of 170 MMDAs, had functioning internal audit units even with uneven impacts and varying compliance with standards aligned to those of the Institute of Internal Auditors (IIA). Worthy of note is that, budget allocations to staff and operational costs reportedly have not been sufficient to meet the Unit's operational needs. The IAA is therefore unable to attract qualified personnel with the requisite skills and competencies to perform specialized audits. Moreover, the implementation of the internal audit function, as outlined in the Act was weakened because the Act did not set aside traditional pre-audit functions and business processes. As a result, short of financial incentives to civil servants to adopt change, many held on to old practices and that did little to build demand for modern control processes within government.

Budget Systems

Reforms in budgeting systems have had considerable attention by government and policy makers over the years but with very little success. In 1997, the Budget Planning & Expenditure Management System (BPEMS) was introduced under the Public Financial Management Reform Program (PUFMARP). The objective was to develop an integrated

system to manage the full cycle of expenditure from budget preparation through execution to the preparation of accounts with the use of Oracle Financial System. BPEMS is an Integrated Financial Management Information System (IFMIS) designed to incorporate budget management accounting and reporting functions into one interface for efficiency. The project design for BPEMS was criticized for being technology-driven. It failed to give sufficient attention to change management issues, capacity and training needs, and just as important failed to adopt a more gradual “incrementalist” approach (Lawson, 2012).

A further challenge to BPEMS was the lack of ownership and fundamental weaknesses in the design, management and leadership of the project which contributed to its poor implementation. Managed mainly by consultants, the project lacked top level commitment from key stakeholders such as the Controller and Accountant General's Department (CAGD). The consultants did not have the functional responsibility for budget execution and processing or the operational responsibility for implementing reforms. As a result it became an enclave project and distanced itself from its principal client departments (CAGD and the Budget Division of the Ministry of Finance). As one observer remarked, the unwillingness on the part of senior government financial managers to commit to operating through BPEMS and the lack of political leadership in ensuring a clear champion such as the CAGD to lead the process contributed to the systems failure (Lawson, 2012).

As well, BPEMS was hampered by poor system's connectivity to the Wide Area Network (WAN) which was required to link the users to the live version of the software. Technical problems such as poor communication infrastructure contributed to the poor transmission speed to the point where the network was virtually unusable. Contractual issues with vendors contributed to delays in resolving the connectivity problem and resulted in delays in the roll out of the system.

By 2010, despite the huge investment expenditure of over US\$ 20 million, the system was not fully operational in any of the 8 pilot MDAs. A 2008 field review showed that in 2007 only 6% of total 2007 expenditures were captured through BPEMS (van der Helm et. al, 2008). Moreover, much of the software and hardware had by this stage become obsolete and required further upgrades. A review of the project was undertaken in collaboration with the World Bank, and a new US\$55 million project to install a new financial management system (GIFMIS) was agreed in 2011. The first phase of GIFMIS has been completed with the second phase currently underway.

Payroll Management

To deal with staff costs, the GoG introduced a personnel and payroll database in 1993. The government installed the Integrated Payroll and Personnel Database (IPPD1) (a

French system called SIGAPIP) which according to the 1995 ERPFM was no longer supported. Government since 1998 has been determined to develop a human resource system including payroll management – the IPPD2 from Oracle to have a common database infrastructure with its accounting systems. The development of IPPD2 initially encountered funding problems due to its dependency on project financing and contractual conflicts similar to that of BPEMS. To ensure its success the government took the decision to finance the development of IPPD2 just as it did with BPEMS.

While the IPPD2 is a modern and improved payroll management system, concerns were raised about the accuracy and completeness of data with resulting errors in payroll. The errors as expressed in the 2007 ERPFM appear to reflect a range of problems, including data inaccuracies (e.g. people being incorrectly identified as ghost workers), database problems, server capacity, as well as system crashes. These resulted in errors being made in the size of deductions and payments made to workers. Further challenges include the lack of pay notices being sent, which together with delays in the transfers to bank accounts, causes confusion to civil servants; the lack of a remote back-up facility; insufficient back-up generators, and the lack of documented payment histories, has led to the inability to validate the accuracy of salary arrears.

11.2 Challenges to PFM Reform

Ownership

A large part of the reason for delays in implementing BPEMS was due to limited involvement and ownership of the design of BPEM by significant stakeholders in the government notably the CAGD and MOFEP. The design and development was largely driven by external consultants and donors in the formative stages of the project. In contrast to countries like Uganda and Tanzania, where similar IFMIS projects have been led by the Accountant General's department, the GoG set up a BPEMS secretariat, which was not quite fully integrated with the AG's department or the Ministry of Finance. The Secretariat was staffed with a relatively large number of consultants who were not civil servants and who therefore had difficulties getting support from the top civil servants in the MOF to move the project forward.

Khemani (2003) also reports that the BPEMS design was highly centralised with limited MDA involvement at the design stage. As a result, the pilot MDAs did not make adequate provisions to move into the implementation stage. For example, BPEMS-dedicated computers were not budgeted for and dedicated staff to handle BPEMS were also not budgeted for. With limited buy-in in the initial stages, pilot MDAs and even CAGD staff waited to be convinced that the system is good enough before fully operationalising their functions with the BPEMS software.

Parallel Reforms

PFM reforms in Ghana have been adversely affected by the introduction of multiple solutions to address the same problems. Years after BPEMS was introduced, the CAGD continued to use another system known as ACCPAC in preparing public accounts and monthly and annual accounts. The idea was that once BPEMS was fully operational then ACCPAC will no longer be needed (van der Helm et al, 2008). However, the implementation of the two systems together ironically affected the full implementation of the BPEMS as CAGD staff got comfortable with the existing system and did not see any need to support and move onto the new BPEMS system. The 2008 review by van der Helm et al also found other systems like the Budget Management System (BMS), National Expenditure Tracking System (NETS) and Activate that were all being used in parallel with BPEMS. The functions these systems were used for could all in theory be performed with BPEMS which was the more overarching system but no one saw the need to abandon their seemingly functioning system to adopt the overarching system.

Inappropriate Sequencing of Reforms

For many reforms, success typically depends on how well the reforms are sequenced in implementation. Some reforms are unlikely to achieve their impact unless other reforms have reached a certain level of impact. For example, an MTEF whose basic pillar is expenditure control will have limited success in an environment with low levels of aggregate fiscal discipline, which has no fiscal control procedures in place. Diamond (2013) suggests that sequencing should be guided by PFM priorities as determined by the relevant parties implementing the reform programme. He states that reform actions should be guided by 3 main priorities in the following order: first, putting in place measures to ensure fiscal control; second establishing mechanisms to promote fiscal stability and thirdly, introducing systems to promote efficient and effective service delivery. This list was developed from an assessment of best practice in PFM reforms around the world. In this chapter we do not go so far as to suggest that Ghana should follow this exact sequence but the main players in the reform process need to establish their order of priorities and sequence actions based on these priorities. Implementing actions out of order creates delays and undermines the effectiveness of the reforms. Sequencing also supports the notion that reforms should be implemented gradually with the basics introduced prior to introducing more technical and comprehensive aspects of the reform rather than adopting a big bang approach where all aspects are being implemented at the same time.

Fragmentation of PFM Reforms

The lack of sequencing has created an environment of fragmented reforms with several initiatives going on at the same time. Although the PUFMARF was meant to be a comprehensive all-encompassing strategy, implementation of the various aspects has

proceeded at different speeds and as a result there are several reforms in effect at any given time. Another factor causing fragmentation of the reforms is a lack of an overarching framework for overall coordination, sequencing, funding, implementation and monitoring of the reforms. Instead the recent Sector Medium Term Development Plan (SMTDP) details the reforms at a technical and administrative level without the overall framework being outlined. This leaves the reform process as a series of free-standing and parallel activities (ECORYS 2013). Due to the fragmentation, donor support to PFM reforms has also been fragmented, limiting its impact.

Limited capacity of staff to implement reforms

Local capacity and know how to implement the various PFM reforms has been limited. For BPEMs in particular, there was very little capacity within the government to handle the software design and development and the government therefore had to rely heavily on external consultants who were not fully integrated into the government service creating further ownership difficulties. Even where GoG officers were used, these were mainly national service personnel contracted to work for a year. As a result, there was high staff turnover with very little institutional knowledge being passed on to core GoG staff.

The training programme for BPEMS had initially been set out as a comprehensive training programme. However due to the pilot MDAs proceeding at varying degrees of speed, training was reduced to individual or limited group training at various times as and when new staff were hired for BPEMS functions or took on schedules that required them to have BPEMS knowledge. As well, this training provided on an ad hoc basis was specific to the roles the trainee was going to perform without sufficient overarching knowledge about the system and its inter-linkages. Training invitations were issued to Chief Directors of MDAs who were asked to nominate staff for the training. However as a result of training incentives that generate rent-seeking behaviours, the right people who needed to attend the training were not always the ones who actually attended. There were no clear definitions of the functional roles required to receive training. Others who did need the training also had very little knowledge of computers and had to be trained on basic computer knowledge before further training on the BPEMS functions (van der Helm et al, 2008).

The implementation of a similar Integrated Financial Management System (IFMIS) in Tanzania is widely regarded as one of the most successful in Anglophone countries (Diamond and Khemani, 2005). A key aspect of its success was in embedding the process in the Ministry of Finance (MOF) coupled with an emphasis on capacity building, particularly in the Accountant General's department.

Inadequate Focus on the Process of Change

Previous PFM reforms have been limited by a lack of sufficient attention to the process of the reform or how to achieve the correct enabling environment. Technical solutions have been suggested without consideration for changing the underlying processes that will create the right conditions for the technical solution. For instance, the design of the BPEMS project involved an automation of the existing manual budget execution process rather than an overhaul to create a budget execution process that will be compatible with the use of an IFMIS. The Tanzania IFMIS project focused on developing enabling legislation, accounting principles systems and organisational arrangements necessary for the management of the new budgetary and accounting system (Diamond and Khemani, 2005). In Ghana however, the system provided technological solutions with little interest in improving and modernising the underlying processes.

Coordination of reforms across departments

Other departments were not necessarily aware of what others are doing in terms of the reform and therefore were not obliged to adjust their workflow in line with the ongoing reforms. For example, the budget reporting function in MOFEP relied for a long time on paper documentation where releases were recorded manually on a daily basis rather than using the BPEMS system to generate reports on the releases that have been made as part of the process of preparing annual and semi-annual expenditure reports.

11.3 Recommendations

Going forward, there is high level of support for PFM reforms from the Ministry of Finance. The technical and administrative aspects of implementation however will have to be strengthened to take advantage of the political support to ensure success of the reforms. The following is a set of recommendations based on what has worked in other countries that can help Ghana's reform effort. While this does not pass itself off as a comprehensive list of all best practices, it provides a synthesized view of what has worked for implementing successful reforms in other countries.

1. Reforms must be part of an overarching strategy, spelling out how and what to reform. In other words the strategy must spell out the process of reform, the instruments of reform, the roles and responsibilities of all central agents of reform, and must also spell out what needs to be changed and to what end. It must not be bogged down by technical and administrative details at the individual reform level. As the 2012 PEFA report notes, the existing framework for PFM reform does very little to provide an overview of the change process, and this has resulted in multiple free-standing reform actions being implemented at the same time.

2. Reforms also require commitment at the highest political and administrative level. In Ghana the Minister of Finance is the final authority for releases of large value. Without a committed Minister, fiscal rules may be set aside for political expediency, undermining the reform process. One country that has performed well in the area of PFM reform is Tanzania and reviewers have attributed the success to a solid backing at the political level, which trickled down to the management level; with both political and management commitment being strong throughout the entire reform process. In a study to assess the performance of PFM reforms in 15 HIPC countries, de Renzio and Dorotinsky found that greater government commitment was positively and significantly related to PFM reform success as measured by PEFA indicators (Diamond & Khemani 2003, De Renzio & Doritinsky, 2007).
3. Reform should be embedded in the Central finance agencies; namely, the Ministry of Finance and the Controller & Accountant General's Department with an emphasis on capacity building, through training, restructuring, and computerization. The Ghanaian experience shows that the setting up of enclave secretariats as in the case of the BPEMS limits effectiveness especially if the secretariat officials are not civil servants, as has been the case in the past. Instead, senior officials of the civil service should be fully involved in the reform process.

Oversight functions are generally weaker in the hands of a semi-autonomous secretariat, where the head of the secretariat still needs to defer to the civil service directors for decision making. Oversight should instead be incorporated into the work functions of existing directors to facilitate decision making and implementation. In Uganda, the introduction of both the MTEF and IFMIS were championed by the Ministry of Finance Commissioners and the Accountant General. Although the Government made use of local and international consultants, these were mainly the functionaries and not in charge of high level decision making.

4. The PFM reform work should be linked to a monitoring and evaluation framework that evaluates progress periodically and incorporates lessons learnt in order to improve the ongoing reforms.
5. Reforms must be country led with donor financial and technical support provided to support the vision of the reform. A lot has been said in the aid effectiveness literature about donors allowing partner countries to lead the reform process. PFM reform in Ghana requires strong country leadership with less reliance on donors or consultants to push the reform agenda. A 2012 Overseas Development Institute (ODI) review report notes that success in PFM reforms in Afghanistan was due to an agreement between the country and international partners for the partners to use the national budget as the main tool for policy prioritization and for all finances to be controlled within the Ministry of Finance. Diamond and Khemani (2005) also note that contrary to what pertains in other countries where the Government

implements reforms mainly at the urging of donors, in the case of Tanzania's PFM reforms, both the Government and donors recognized the importance of the reforms and worked together towards a common goal with the Government providing strong leadership.

6. Coordination and cooperation in PFM reform is also vital for success. As noted as part of the challenges, not all PFM stakeholders are aware of the reform strategy being adopted. Success requires stakeholders like the Ministry of Finance, the CAGD, MDAs, Ghana Revenue Authority (GRA) Parliament, and the Auditor-General among others to be fully aware of the different aspects of the reform that are being implemented by the various institutions. This reduces duplication in reform efforts reducing waste and fostering value for money.
7. Special attention must be paid to the timing and sequencing of the reforms. An example of the challenges associated with inappropriate sequencing relates to the introduction of the MTEF in Ghana. The MTEF was introduced alongside an activity based budgeting tool known as Activate with relatively complex functions that required some staff skill. As a result the MTEF, was directly associated with this tool generating little interest in the initial stages due to the complexity. In contrast, Uganda introduced the concept of the MTEF in a relatively simpler manner with focus on the multi-year budget ceiling and planning. Once MDAs assimilated the concept of planning and budgeting for the medium term instead of an annual basis, the Government introduced Output Based Budgeting (OBB) which linked the multi-year planning of the MTEF to an output based planning framework. While the new OBB was still fairly complex, it was met with less distrust due to the confidence already built in the MTEF process.

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