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THE GENESIS AND SOLUTIONS TO GHANA'S CURRENT ECONOMIC CRISIS

by
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Summary

It is probably an understatement to say that Ghana is facing one of the most serious economic crises in its history. The coming together of a myriad of problems currently confronting the economy seems almost unprecedented. Economic growth has been slowing. The budget deficit has been at double digit for two years running, with a stockpile of payment arrears. The external current account deficit has been at double digit. The public debt has been rising rapidly. The Cedi has seen rapid depreciation in the past 15 months. Over the same period, inflation has risen steadily back to double digit, aggravating an already high cost of living. And above all, the underlying structure of the economy remains weak.

The economic problems facing the country are not unrelated. The slowing growth has contributed to the high budget deficit by dampening taxes. The high budget deficit has led to high public debt due to borrowing; it has contributed to the surge in inflation and rapid currency depreciation by increasing demand pressures; it has, in part, led to high interest rates because of competitive government borrowing; and it has contributed to the high external current account deficit by fuelling imports. Currency depreciation is partly responsible for rising inflation due to higher cedi-denominated import prices. High inflation has contributed to the currency depreciation by reducing the relative purchasing power of the local currency. The widening external deficit is partly responsible for the currency depreciation, reflecting the growing gap between foreign exchange demand and supply. The weak structure of the economy is behind slowing growth, financial imbalances and price and currency instability.

IEA Ghana

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Considering the problems separately will allow for deeper analysis.

After posting record high growth of 15% in 2011 (the first full year of oil production), and 7.9% in 2012, economic growth is estimated to have slowed to less than 6% in 2013. Slowing growth is the result of normalization of the oil impact, low export commodity prices, slow agricultural growth, erratic power supply, and low public investment, in part due to revenue shortfalls and low donor disbursements. For this year, growth may probably slow down further, unless many of the dampening factors improve.

The fiscal deficit has been high and contributed to overall macroeconomic instability. The deficit was 11.8% of GDP in election year 2012 compared with a (revised) target of 6.7%. The excess resulted largely from higher spending fuelled by wages, interest costs and subsidies. A substantial amount of arrears to contractors, the DACF, GETFUND, NHIF and Road Fund was accumulated. In 2013, the deficit was 10.8% compared with the target of 9%. The excess resulted from lower revenues (including grants) without commensurate reduction in expenditure, which was dominated by wages and interest costs. Meanwhile, a substantial amount of arrears was again accumulated.

The public debt reached 58% of GDP at the end of 2013. So far this year, it must have already exceeded 60%, a level many analysts consider to be the sustainable threshold. In retrospect, the public debt that had risen above 100% of GDP was reduced to around 26% in 2006 when Ghana benefited from HIPC and MDRI reliefs. The pace of recent debt accumulation has alarmed many analysts who warn that Ghana could return to HIPC status sooner than later.

The external current account deficit was above 12% of GDP in 2012 and 2013. This is high by all standards and reflects the high deficits on the trade and services accounts. Import demand has been growing rapidly as a result of inadequate domestic industrial production. This is due to a stagnating manufacturing sector that faces a multitude of bottlenecks, including poor infrastructure, erratic energy supply and high cost of credit that have rendered the sector uncompetitive. On the other hand, export receipts have been stifled by continued dependence on low value-added products.

The Cedi depreciated by15% in 2013; and this year, it has already depreciated by 20%. The sharp depreciation is just the flip side of the high external account deficit, essentially because of the widening gap between foreign exchange supply and demand. The Bank of Ghana responded to the crisis by tightening monetary policy and regularising existing regulations in the foreign exchange market. The measures have the potential to reduce demand for foreign exchange; but they could also reduce supply particularly in the formal market. The pace of depreciation and volatility in the exchange rate, have reportedly slowed so far. It is widely believed, however, that far-reaching measures are required to stabilize the currency on a long-term basis.

Inflation that had been kept at single digit for 2 ½ years between June 2010-December 2012 rose steadily from 8.8% in December 2012 to 14.5% in March 2014. This is the result of the currency depreciation, periodic upward adjustments in fuel and utility prices and rising food prices. Given its limited coverage and other measurement inadequacies, the official measure of inflation may not even fully capture the much-higher general cost of living.

Finally, the underlying structure of the economy remains weak, with a narrow production base and heavy dependence on primary, unprocessed export products. The persistence of a "colonial economic structure" has stifled economic growth and development and manifested in general economic and financial imbalances. The

need for a major transformation of the economy has been widely acknowledged, with the President reiterating it in his last State of the Nation Address to Parliament.

The Solutions

As a matter of urgency, the budget gap has to be closed to safeguard macroeconomic stability. The way to close the gap is to increase the tax effort and reduce expenditure. The tax-to-GDP ratio of 18-19% is low by middle-income country (MIC) standards. The tax effort needs to be increased, not by raising existing rates which are already high but by expanding the tax base in particular by roping in the informal sector reducing the spate of exemptions, reducing tax evasion, fraud and corruption and by strengthening tax administration. Meanwhile, expenditure of 34-35% of GDP is too high and has to be reduced. To that end, it may be necessary to revisit the Single Spine Pay Policy (SSPP), which constitutes a substantial part of government expenditure. All relevant stakeholders should be engaged in a dialogue to consider the SSPP's long-term viability and any reforms that may be needed in that regard. Public sector reform should also be carried out as a matter of priority. This may have to involve down-sizing the entire sector, including government. Reform should also aim to increase productivity commensurate with remuneration. Closing the fiscal gap through the measures suggested above will help stem the emerging debt crisis by slowing the pace of borrowing. Further, it is critical that loans are used to develop the economy to enable it 'grow out of debt.' It will be a fatal mistake to divert loans to fund recurrent spending such as wages, interest, subsidies and other goods and services that do not have a direct bearing on growth.

The widening external imbalance can be narrowed by increasing domestic industrial production by addressing the several bottlenecks mentioned above. It is also important to add value to our exports through more processing. These policies will also help stabilize the cedi on a long-term basis by increasing availability of foreign exchange while reducing demand through imports. Meanwhile, fiscal consolidation, as stressed above, will also ease demand pressure on the cedi.

Fighting inflation on a durable basis requires increased industrial and agricultural production. Food alone has a weight of 44% in the CPI basket. If we are able to produce enough food to feed ourselves, the cost of living in the country will be cut nearly in half. We also have to keep domestic demand under control so that it does not unduly 'pull up' prices. Since a large part of domestic demand emanates from the budget, fiscal consolidation suggested above is critical. There is the need also to increase labour productivity so that wages do not unduly 'push up' production costs and prices. Further, the utility services have to be more efficient by reducing their production and distribution costs. This will help reduce the pace of tariff increases and the effect on inflation.

There is no gainsaying that the economy is cash-strapped. This, in part, is the result of weak revenue performance due to a slowing economy and the other factors stifling taxes. It is also because the wage bill, interest costs and other statutory payments continue to overburden expenditure. Meanwhile, a stockpile of arrears represents a potential source of spending pressure. Compounding the cash crisis is the slow pace of disbursements by donors because of perceived weakness in public financial management. It has become obvious that the large financial deficit cannot be funded in a manner that does not further exacerbate the public debt or cause more inflation and further currency depreciation. The deficit has to be reduced through serious austerity or adjustment in the form of cutting expenditure and increasing tax collection. However, it has been

difficult in the past to undertake strong fiscal adjustment on our own watch when needed without the umbrella of an IMF programme. This is because of entrenched expenditures and difficulties with increasing taxes. The choice for us is quite clear: we have to undertake the needed fiscal adjustment on our own or in the context of an IMF programme. Closing the financing gap will regain investor and donor confidence and ensure a reflow of resources into the country. This will help prop up the cedi with attendant benefits, including soothing inflation.

Finally, the need to transform the economy from its colonial structure cannot be over-emphasized since that is at the core of many of the other problems facing the economy. In this regard, there is the need to move from rhetoric to concrete policy action. Industrialization should be promoted as a matter of urgency through state policies that address impediments to domestic businesses and that stifle competitiveness, including the large infrastructure deficit, high cost of credit and unfriendly trade policies. Adding value to our exports should be a policy priority so as to increase foreign receipts.

The bottomline to addressing the economic crisis facing the country is clearly fiscal adjustment in the short-term and structural transformation of the economy over the medium- to long-term. We should boldly and vigorously pursue this agenda without pandering to the interests of any particular constituencies. "*There should be no hesitation and no turning back.*"

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