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PROPOSED POLICY MEASURES FOR THE NEW ADMINISTRATION

by

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Introduction

The poor state of the economy underscores the need for the present administration to harness all the technical, physical and financial support it can muster if it is to successfully revive the country's ailing economy. Undoubtedly, the heightened expectations of the masses, buoyed by euphoric campaign promises, places even greater pressure on the administration to succeed. The gravity of the situation invariably calls for an effective public relations campaign to manage the expectations of the general public and constructive input at all levels including civil society. It is in this context that the IEA proposes the following policy measures to assist the administration in formulating economic policy during this challenging period. The proposed economic policy measures fall in two categories: the short term (defined as a period of 3-12 months) and the medium to long term (2 or more years from now). Fiscal and monetary policy measures are proposed under each time period. Policy proposals for the real sector are equally important and will follow at a later date.

- **Short-Term Fiscal Policy Measures**

I. FOSTER TRANSPARENCY

Report on the State of the Economy

In the short run, the government's policy options are limited. However, the first order of business should be to *provide a comprehensive account of the state of the economy*. This will assist policy analysts in identifying critical areas of intervention. Furthermore, to promote a spirit of transparency, accountability and consensus building, the new administration should *engage in continuous dialogue with civil society* on issues of national importance as they arise. The fruitfulness of such dialogue will be considerably enhanced if, on a continual basis, the new administration *keeps civil society well informed about the issues*. In lieu of such information, however, recommendations in the area of fiscal and monetary policy can serve as useful guidelines.

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II. RAISE REVENUE

1. *Seek Additional Donor Support*

To expand its revenues, it is suggested that the government request for additional donor support to bridge the financing gap. Such support can take a variety of forms including bilateral *debt cancellation* as volunteered by the Canadian government (CND$18.2 million) and comprehensive (bilateral, multilateral and commercial) debt reduction as provided by the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative. Access to adequate quick-disbursing donor funds will *ease the pressure currently being exerted by the Japanese government* on the new administration to forego HIPC as a precondition for continued bilateral loan-aid from Japan.

2. *Raise Fuel Prices Incrementally*

The issue of petroleum pricing is critical to the fiscal integrity of the economy. To ensure the economic survival of the Tema Oil Refinery and minimize the risk exposure of its financing institution, fuel prices must rise to cost recovery levels.

However, *the potentially inflationary impact of such a policy and the associated economic hardships, suggest the need for an incremental rise in prices to achieve cost recovery. The increase should however be front-loaded since public sympathy for the new administration is currently high and also because given the recent decline in crude oil prices, Tema Oil Refinery will reap higher returns and thereby recoup its losses at a faster rate if the greater proportion of the fuel prices increase occurs immediately.*

Furthermore, *the new administration must consider redirecting the revenues generated from the fuel tax to pay for the debt incurred by the Tema Oil Refinery.* Currently fuel taxes account for over 27 percent of the ex-pump price of gasoline. *The current price differential between diesel and gasoline is so miniscule (¢95) that, there is no incentive to substitute one for the other. A wider price differential between diesel and gasoline prices would serve as an incentive for private transport service providers to switch to the cheaper brand and minimize the impact of high fuel prices on the average consumer.*

Failure to increase *fuel prices will definitely send the wrong signals to both domestic and foreign investors who would rightly perceive the situation as unsustainable.* This could undermine the nation's fragile macro-stability if, in anticipation of further economic decline, individuals engage in hedging activities such as investing in foreign currencies to maintain their purchasing power and thereby cushion themselves from further economic shocks.

Indeed, *speculative activity on the currency market, engendered by the perceived un-sustainability of the current petrol price subsidy, can send the currency into another tailspin,* raise the domestic currency price of imports, increase the general price level and further compound the nation's macro-economic woes.

Furthermore, delays in raising the fuel price will further increase the nation's indebtedness, threaten the viability of TOR and expose the financial sector to greater risk.

Lastly, public sentiment appears to be ripe for a price hike; hence, any delays in taking advantage of the goodwill of the public could be unwise.

3. *Recover Monies Owed to Government*

Other short-run measures to maximize government revenue should focus around the *recovery of domestically and externally* *guaranteed government debt* (e.g. Capital Telecom, National Investment Bank, SSNIT, SIC, Ghana Commercial Bank, Divestiture Implementation Committee and CASHPRO) *and debts directly owed to government under various loan schemes* such as the Business Assistance Fund (BAF), Youth in Agriculture Program (YAP), Poverty Alleviation Fund (PAF) and the Council of Indigenous Business Associations (CIBA). Sums owed to government under such schemes are estimated to run into several millions of dollars.

Furthermore, the *U.S. has pledged in principle to assist government in recovering ill-gotten wealth stashed in US bank accounts*. Every effort must be made to capitalize on this opportunity.

4 Do Not Raise VAT

The IEA is of the view that the Value Added Tax rate be maintained at its current level of 12.5 percent. *Instead of increasing the VAT rate, efforts must focus on widening the tax net through more effective enforcement mechanisms and by providing incentives to encourage a greater number of informal sector enterprises to operate in the formal sector.*

To *forestall the misapplication of the portion of the VAT allocated for the Educational Fund (2.5 percent)*, the accounts of the Fund must be current and open to public scrutiny.

III. MINIMIZE EXPENDITURE

Reduce Unproductive Expenditure

Reducing unproductive and wasteful expenditure provides another opportunity for government to maximize its available resources. In-kind or non-monetary remuneration (also known as perks) are a source of hemorrhage in government resources because there are virtually no limits on the enjoyment of perks. To address this problem, policymakers must impose a ceiling on perks to government officials, or replace perks with fixed cash payments. For instance *unlimited use of phones, cars, utilities, fuel etc., by government officials can be curbed by imposing quantitative limits on such benefits, or providing lump sum cash benefits*. Individuals who exceed their in-kind quotas must have such excesses deducted at source from their salaries.

- **Short Term Monetary Policy Measures**

Given the progress of the Central Bank in reducing money supply over the last few years, government should continue to foster and respect the independence of central bank. This will ensure that the central Bank does not accommodate government debt. Furthermore, government must cooperate with the Central Bank to reduce the rate of money supply growth to a level that is consistent with single digit inflation. But, *most importantly, government in cooperation with the Central Bank must pursue a policy of "zero tolerance" for debt monetization.*

- **Medium-to Long-Run Fiscal Policy Measures**

1 Improve Tax Compliance

In the medium to long term, prudent fiscal policy should adopt a more aggressive posture with respect to tax collection. However, it should be noted that individuals are more likely to pay their taxes if it translates into visible improvements in infrastructure and service delivery.

A concrete measure to raise revenues without necessarily raising taxes is to fund an independent study to estimate the revenue generating potential of key revenue generating institutions such as the Customs, Excise and Preventive Services, IRS and the VAT Secretariat. That estimate can then be used as a yardstick or target to assess the unit's effectiveness in carrying out its mandate of revenue collection. A system of rewards and penalties can then be put in place to encourage the achievement of the estimated targets.

The suggested policy measure can be applied in the Motor Traffic Unit to simultaneously reduce traffic violations and raise revenue from fines. The possibility for corruption will be reduced since the MTU will be required to meet a revenue target based on independent assessment of its revenue potential. Hence, the Head of the Unit will be forced to put in place the necessary measures to meet the required targets, or face the possibility of dismissal. It is important to note that the success of this program will depend on the resources at the disposal of the MTU or revenue generating institution. Nevertheless, it is still possible to have targets that explicitly take into consideration the level of resources available to the institution. In effect, *targets must be lower for Departments or institutions that are under-resourced but relatively higher for more adequately resourced institutions.* Conceivably, a percentage of the revenues generated from such a policy can be ploughed back to enhance the resource base of the participating institution.

2. Harmonize Fiscal and Monetary Policies

The lack of harmony between fiscal and monetary policies was the bane of the previous administration. This *administration must at all costs curtail government borrowing to a level that is at least consistent with the macro targets* set out for the Second Monetary Zone. Ultimately however, government must strive to achieve a balanced budget by the end of its term in office.

3 Re-Constitute Divestiture Implementation Committee

To maximize revenues from the divestiture process and ensure that privatization promotes the national interest, *the rationale and objectives of the divestiture process must be re-examined.* There is no reason to believe that maintaining some level of indigenous ownership necessarily compromises the efficiency and profitability of divested firms. Hence, *divestiture must be guided by an overarching framework or vision that balances the desire to retain some degree of indigenous ownership with the competing objective of profit maximization in a competitive environment.* Furthermore, the ubiquitous tendency for graft, avarice, greed and corruption to thwart the best intentions of the DIC can be minimized by *revamping the composition of the DIC to reflect the broad and diverse interests of businessmen, civil society and workers.* The underlying rationale for this proposal is that *the competing and conflicting interests of a diverse committee membership can act as a check on the narrow interests of a few interest groups.*

4. Reduce the Domestic Debt Service Burden

Provisional estimates place the domestic debt service currently at 30 percent of total revenue. The high interest rates on the domestic debt, coupled with their short maturity periods imposes a severe constraint on the country's limited resources. Incidentally however, due to the depreciation of the domestic currency the domestic debt stock has depreciated in value with respect to the US dollar. Hence, borrowing dollars at concessionary rates (e.g., through the International Development Agency) to pay a portion of our domestic debt provides an opportunity to finance our debt at a discount. Secondly, government must alter the term structure of the domestic debt by offering incentives for Treasury Bill holders to hold long-term debt instruments such as zero coupon bonds. On maturity, such instruments involve a one time lump sum payment equivalent to the difference between the purchase price and the face value of the bond (i.e., the discount rate). For holders of zero coupon bonds to benefit from such instruments the discount rate must be at least higher than the rate of inflation. Hence, this strategy will most likely be successful if individuals believe that inflation will decline over the long run. Thus, such a policy must be associated with government's commitment to fiscal discipline.

5. End Practice of Arrears to Private Sector

The previous administration piled up billions of cedis in arrears to domestic private sector firms but failed to make interest payments on such accrued debts. *This practice undermined the economic viability of the private sector by implicitly raising their cost of production.* Furthermore it may have exposed the institutions that pre-financed the project expenditures of locally based contractors to greater risk. Unwittingly, this may also have contributed to the rise in the interest rates, and the large spread between the lending and savings rate in Ghana.

6. Tie Wages to Productivity

The wage-setting mechanism in the public sector in Ghana has traditionally been a political "hot potato", particularly during election years. Traditionally, the cost of living has been a key determinant of wage hikes, with little attention given to productivity. Presumably, the absence of an index of productivity in the wage- setting mechanism can be attributed to difficulties in measurement, particularly in the services sector. As a step to basing wage increases on a weighted average of key indicators including, but not limited to, inflation and productivity, *the administration should set up a committee to design a methodology for measuring productivity, particularly in departments or institutions where output is easily measurable.* The alternative of exclusively linking wages to the cost of living is unsustainable since it compounds the inflationary cycle by increasing consumer capacity to spend even where production is stagnant or even declining.

7. De-Politicize Fuel Price Setting

On the politically sensitive issue of fuel prices, the new administration should seriously consider de-politicizing the fuel price-setting mechanism by *allowing market forces to determine prices*. It may however, retain the option of *intervening on the market by reducing fuel taxes which currently account for over 27 percent of the ex-pump price.*

As a long-term policy, the administration should seek funding to reduce fuel price impact on food and the poor by further *developing the country's rail network and constructing an intra-city rail transit system.*

8. Review Vision 2020 Fiscal Targets

Finally, the incoming administration must conduct a thorough review of the Vision 2020 fiscal targets in the context of the present state of the economy. Such *review must be ongoing and continual to reflect changing conditions and circumstances*. The vision must be viewed as a dynamic process and not a static exercise merely designed to fulfill a conditionality.

- **Medium-to Long-Run Monetary Policy Measures**

Encourage Foreign Currency Deposits

On the monetary front, stabilization of the domestic currency can be enhanced by *encouraging inflows of foreign currency*. One way of achieving this objective is by *paying interest on foreign currency deposits*. Even if interest payments in foreign currency is considered a risky or expensive proposition, *the ability to make some interest payments, even in domestic currency, is preferable to no payments at all*, since it encourages foreign currency inflows and deposits which in turn assist not only in stabilizing the domestic currency but in the procurement of imported inputs.

The administration should also *make the establishment of the second monetary zone a priority*. A strict policy of macroeconomic stability will help meet the criteria set for membership of the monetary zone. Furthermore, the administration should *review Vision 2020 monetary targets in the context of present economic conditions*.

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