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PUBLIC SECTOR CORRUPTION AND MACRO-STABILITY: EVIDENCE FROM THE AUDITOR-GENERAL'S REPORTS

by

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Introduction

The Auditor-General is charged with the responsibility of ensuring that public accounts are properly kept; that all monies are fully accounted for and rules and procedures applicable are sufficient to secure an effective check on assessment, collection and proper allocation of revenue; that monies are expended for the purpose for which they were appropriated, and expenditures made as authorized; that essential records are maintained; that rules and procedures applied are sufficient to safeguard and control the property of public institutions; and that financial business is conducted with due regard to economy.

Over the period 1993-1999 the Auditor-General's Reports identified disturbing trends in the management of public accounts. The Reports revealed several instances of wasteful expenditure, extravagance or lack of economy in the administration of financial resources, poor standards of accounting despite previous criticisms, and the tendency to transact financial businesses and activities without regard to applicable rules. The findings had serious

implications for macro-economic stability. To what extent did the various instances of financial malfeasance, negligence and waste compromise macro-stability? Focusing largely on the fiscal dimension, this paper identifies aspects of the Reports that impact on the macro-economic aggregates of the economy. Malfeasance worsens the fiscal deficit by depressing revenues and or increasing wasteful or extravagant expenditure. Fiscal imprudence in turn undermines monetary stability if the Bank of Ghana is instructed to print money to finance the fiscal deficit, or if government engages in excessive borrowing to achieve the same purpose. Debt monetization fuels inflation and depreciates the domestic currency, while excessive domestic borrowing raises interest rates, chokes off private sector investment, and similarly increases the rate of inflation when the higher cost of credit is passed on to the consumer.

The Fiscal Dimension of Public Accounts Mismanagement

Fiscal prudence requires the maximization of government revenue and the pursuit of a policy

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of cost-effective expenditures that invariably expands the revenue base by creating an enabling environment for increased investment and productivity. Deficits per se are not undesirable; they can be justified if the expenditures arising from the deficit are cost effective, and contribute to revenue maximization in the long run. Failing this, deficits will be unsustainable and consequently, impose a debt overhang on future generations. The Auditor-General's Reports exposed practices that impact on both revenues and expenditures. The following sections examine factors identified in the Reports that have undermined government's revenue generating efforts. This is followed by an analysis of similar factors that have unnecessarily bloated government expenditures. The fiscal implications of these trends are then highlighted to guard policymakers against recidivism or a repeat of such errors.

Factors Undermining Revenue

The Auditor-General's Reports identified several activities which had a negative impact on the revenue levels of national and sub-national governments (i.e., District Assemblies). At the national level the revenue shortfalls translate into increased domestic borrowing, higher interest rates and higher inflation, and a depreciation of the domestic currency. At the sub-national level the effect has been reduced liquidity and a resort to alternative and often illegal mechanisms to finance the operating costs of District Assemblies.

Failure to Remit 5% of Government Revenue to the DAs

Article 252 (2) of the Constitution and Section 2 of Act 455 both stipulate that Parliament shall annually allocate no less than five percent of the total revenue of Ghana to the Common Fund (DACF) Administrator for development projects by District Assemblies. The Office of the Administrator is charged with the responsibility of receiving quarterly releases from the Ministry of Finance for onward distribution to the District Assemblies. In effect, there are two stages in the distribution process. The first is the release of funds from the Ministry of Finance (MOF) to the DACF. The second involves the release of funds from the Common Fund to the District Assemblies.

However, the findings of the AG's Reports suggest that since the enactment of the District Assembly Common Fund Law (Act 455) on 5th July 1993, disbursements have not only fallen short of the stipulated amount, but have been characterized by delays in both stages of the release.

Such delays have adverse impacts on the execution of development programs in the Districts, and also on the liquidity position of District Assemblies. Even more importantly, they result in an increase in the cost of projects. Cost overruns can be substantial, particularly in a high inflation environment such as Ghana's. Furthermore, delays in the release of funds contribute to the accumulation of deficits at the district level when commitments are made in anticipation of DACF inflows.

Based on these findings, the Auditor-General recommended that there should be a reconciliation at the end of the financial year to determine whether actual remittances to the District Assemblies are equivalent to 5 percent of revenue. In reality however, the delays in remittances have persisted.

Failure to Transfer Funds into the Consolidated Fund

The Reports cited several instances of failure by District Assemblies and public institutions to deduct the mandatory 5% withholding tax from the salaries of employees. Furthermore, even when the deductions were made, they were not always transferred to central government. In the case of District Assemblies, such funds were used to finance their operating costs. As a result of this trend, government was deprived of much needed revenue, which invariably contributed to the growth of the fiscal deficit. Could this be a response to the unpredictable disbursement of funds to the districts?

It is important to note that even when the withholding tax is eventually released to government, in a high inflation society, the delay not only reduces the real value of such revenues, but also influences timeliness of government allocations to Ministries, Departments and Agencies (MDAs).

The belated releases of funds to the District Assemblies and the failure to transfer the 5%

withholding tax to government, are most likely related since the sporadic releases of District Assembly funds undermines their liquidity position and thereby increases their inclination to finance the operating costs using their withholding tax. As a result, the pace and real value of government revenue collection is compromised.

Suppression of Value Books and Market Tickets

The capacity of local governments to effectively generate and manage internally generated revenues is a vital prerequisite for fiscal decentralization. Market tickets and related receipts provide an indication of revenues raised at the district and local levels through taxation. The Auditor-General's reports cited several instances where market tickets, basic rate receipt books and general counterfoil receipts were not presented for audit by revenue collectors. Suppression of market tickets from auditors is thus an attempt by districts to embezzle locally generated revenues. For instance, in the Eastern Region revenue losses resulting from suppression of value books amounted to ¢26 million in 1993 and ¢20m in 1994.

These findings reflect weak internal control mechanisms at the district level. The supervisory role of finance and staff committees appeared to have had limited impact on the performance of revenue collectors. In fact collectors failed to collect arrears. It is therefore not surprising that most District Assemblies failed to achieve their revenue targets. In some instances they collected as little as 53 percent of potential revenue. These trends suggest that revenue generation at the district level is considerably below potential. It also raises the question of the extent to which fiscal decentralization will promote fiscal responsibility in the current environment

Factors Undermining Cost-Effective Expenditure

The following findings of the Reports point to wasteful, inefficient and illegal use of the country's scarce resources. They provide an indication to policymakers of how government expenditures can be rationalized and made more cost-effective.

Misapplication of Public Funds

The use of funds for purposes or activities that were not budgeted for is contrary to the Financial

Administration Regulation 69, and invariably results in a misallocation of resources, wasteful expenditure and misuse of public funds. The bottom line is that the returns on misapplied funds tend to be sub-optimal and hence, contribute to the growth of the deficit. The Auditor General's Reports uncovered several instances of such malfeasance. For instance, a contract originally awarded for the construction of a dormitory block was reawarded in 1996; the ¢59.3 million which was the value of the contract was, however, misapplied and used in renovating a staff bungalow. Again, monies intended for construction work on a senior secondary block were misapplied for the purchase of 91-day Treasury Bills without prior approval of the relevant District Assembly.

Government Interference in the Use of the District Assembly Common Fund (DACF)

There is a tendency to destabilize the budgets of Districts when government directs District Assemblies to use their funds for activities that are not consistent with their priorities. Evidence of this trend was uncovered by the Auditor-General. For instance, in 1994 ¢2.4 billion was paid by the DACF Administrator to the Ghana Supply Commission for the supply of 11 Mitsubishi Gallant saloon cars and 99 Pajeros. Presumably, the vehicles were to be used to boost revenue mobilization at the district level. However, contrary to the law, the vehicles ordered did not form part of the approved development plans and budgets submitted by the respective District Assemblies for 1994. On the contrary, the authority for the procurement originated from Cabinet and not the District Assemblies themselves.

The issue of relevance in this case is the extent of the District Assemblies' autonomy in the use of the DACF. The Auditor-General was of the opinion that the projects funded from the DACF must originate from the District Assemblies. On the other hand the Minister for Local Government at the time held the view that government had greater scope for determining the use of the DACF. The concern here is that such influence by the central government could result in the misuse of the DACF to serve the narrow interest of the ruling party under the guise of national development. Furthermore, it unduly increases the range of activities and or objectives that the District Assemblies have to undertake without a corresponding increase in their budget. As a

result, it imposes a tighter fiscal constraint on District Assemblies, and increases their tendency to borrow and incur deficits.

Payroll Fraud

Payroll fraud has persistently occurred in different guises, ranging from payment of unearned salaries, retention on payrolls of persons no longer employed, to duplication of payments. Currently personnel emoluments account for the largest proportion (approximately 30 percent) of government expenditure; they crowd out other expenditure categories such as administration, services and investment. In particular, personnel emoluments account for over 60 percent of the total budget of the education sector. The high incidence of payroll fraud identified in the AG's Reports indicates that without necessarily laying off public sector workers, there is scope for reducing the government's expenditure on personnel emoluments. Hence, government can improve its fiscal position by reducing the incidence of payroll fraud. This point is especially valid since attempts at rationalizing the public sector have largely failed to result in any meaningful reductions in the total wage bill.

Specific findings of the Reports include the loss of ₵37.8 billion on the Ghana Education Service payroll in 1998, and the continued payment of salary to a Principal Superintendent for 7 months before her name was deleted from the payroll. The amount involved totalled ₵1.8 million. In another case of duplication of salary payment, an accounts clerk fraudulently split the name of an employee (David Livingstone Agbenohevi into David Agbenohevi and Livingstone Agbenohevi) and thereby succeeded in doubling his salary.

Non-Recovery of MPs' Car Loans

Defaulting on government-guaranteed loans imposes a financial burden on government, and ultimately on the taxpayer. By increasing statutory debt service expenditures, defaulting on loan repayments exerts upward pressure on the budget deficit and invariably on the debt stock. The 1997 AG's Report revealed that as of June 1998, no deductions had been made on loans contracted by 162 members of parliament in July 1997. The explanation given by management at the time was that the monthly deductions exceeded the net pay of MPs. This finding is of significant interest in the light of the current proposal to provide MPs with car loans of up to

\$20,000. Failure to pay car loans by MPs has implications for the macro-economy. To the extent that the loans are guaranteed by government, it will be saddled with the financial responsibility of repaying the principal and any accruing interest payments. The Report indicated that any outstanding benefits would be deducted from the end of service benefits of the MPs. However, it was not obvious whether such deductions would be sufficient to cover the principal and late interest payments.

Penalties Charged on Loans Overdue for Repayments

The judicious use of scarce resources requires that funds are managed in a manner that minimizes cost and maximizes returns. In a resource-constrained economy such as Ghana's, the payment of charges on overdue loans is inexcusable, especially if the delay results from avoidable lapses in the administrative process, and not from a lack of funds. Penalties and charges unduly bloat government expenditures and, in the absence of offsetting revenue inflows, accelerate the deficit. The Auditor-General's Reports reveal that "penalties incurred from belated settlement of external debt facilities...continue to be a feature in the books of BOG". The delay was attributed to tardiness on the part of the Controller and Accountant General, in submitting loan repayment authorization and application forms to the BOG. The Reports further indicated that even in cases where BOG had in its custody repayment schedules of some of the external loans, payment could not be effected without the prior authorization by the CAGD's to debit a specific account for the repayment. The combined losses from penalties paid for late settlement of foreign loans for the second halves of 1997 and 1998 amounted to \$365,208.69 or ₵2.6 billion.

Ineffective Utilization of Grants

Under-utilization of Grants

Grants are of two types, cash grants and commodity type grants. Commodity grants can either be project or non-project type (NPTs) grants. Grants, particularly untied grants, are virtually costless and hence, a desirable source of non-tax revenue. Nevertheless, grants do expire and can only be extended or renewed by mutual agreement between the donor and the receiver. Given the tight fiscal position of government, one

would have expected that the rate of utilization of grants in Ghana would be high. However, during the period 1992-1995, only 27 percent of a total of Y 7.5 billion in Japanese grant aid had been used. For instance, 47 percent of the unused grants intended for small-scale bridges and equipment had expired. One reason for the underutilization of grants is that grant agreements are signed in retrospect, leaving little time to access them. For instance, Japanese Food Aid FY 1995 was signed a year later in 1996.

Type of Grant	Year	Amount Yen	Amt. Used Yen	Balance Yen	Status
Increase in Food Production	1995	400000000	0	400,000,000	Unexpired
Small Scale Bridges	1995	413000000	24400000	388600000	Expired
Science	1995	281000000	16280000	264720000	Unexpired
Equipment	1992	608000000	416026780	191973220	Expired
Total		1702000000	456706780	1245293220	
Total Expired				580,573,220	

Cost Overruns Due to Ineffective Management of Loans

In collaboration with foreign partners, the government on-lends grant aid to eligible private and public entities. Although grants are generally free of charge to government, under project type grants, beneficiaries are required to pay all bank charges levied by the Bank of Ghana and the authorized foreign correspondent bank of the donor. The charges are debited by the foreign correspondent bank against the Bank of Ghana, which is expected to ensure that beneficiaries make the required payments. Between August 1994 and September 1996, five beneficiaries against whom were levied such charges amounting to \$320,707,516.73 defaulted on their payments. Failure to pay such charges in effect increased government expenditure by transferring the cost of the bank charges to government via the BOG. The largest defaulter was the Electricity Corporation (\$200,158,171.74).

Ineffective Use of Grants as a Revolving Fund

Non-project Type grants (NPTs) are a source of concessionary funds for on-lending to public and private institutions. Beneficiaries are obliged to refund the grant amount allocated to them plus any associated bank charges to the Bank of Ghana within a 12-18 month period. The grace period is 6 months. When managed effectively, such grants constitute a revolving fund for

domestic enterprises, and because grants are essentially free, they provide more resources to government for development expenditure at minimal cost. They also reduce the cost to government of providing subsidized credit to domestic firms. However, the use of NPTs in the past has not been cost effective. Due to poor disbursement mechanisms (particularly in the period 1987-1991), loan beneficiaries have failed to reimburse the cedi equivalents to government. The Ministry of Finance, which is responsible for receiving and vetting all applications for funds under the NPT program, has experienced difficulties in ensuring prompt repayment of NPT loans. The Auditor-General's Reports confirmed that approved applications were not accompanied by the requisite bank guarantees. In some instances the guarantees expired before the loans were fully recovered, and in other instances insurance bonds were used as guarantees, even though the face value of such bonds was less than the full cost of the loan. By 1991 the outstanding amounts of loans granted under NPTs totalled c6.97 billion. This represented 36 percent of the recoverable loans.

While the adoption of more rigorous guidelines for guaranteeing loans has resulted in a decline in the rate of default, a substantial share (28.9 percent) of all loans granted under the NPT program were not being serviced at all in 1996. In effect, this component of disbursements has a high probability of becoming bad or irrecoverable debt.

The relatively high rate of default raises the issue of whether it is appropriate for a non-financial institution such as the MOF to be involved in screening loan applications. Does the MOF have the institutional capacity and resources to engage in this line of activity? Would it not be more appropriate for a financial institution to undertake such activities? Currently the only financial institution involved in the disbursement of NPTs is the Bank of Ghana. However, the BOG's role is limited to facilitating the disbursement of funds approved under each grant; it is neither involved in the screening of applicants nor the recovery of loans.

Costs Associated With Not Capturing MDA External Accounts in the Consolidated Fund

The tendency for Ministries, Departments and Agencies to maintain external accounts outside the Consolidated Fund is costly to government

because it results in a situation where the BOG sometimes borrows foreign currency to fund government expenditure, even when MDAs hold external accounts on behalf of government. The issue here is that foreign transfers into the Fund are automatically converted to cedis and assessed a BOG commission of .0375 percent. If such transfers are effected for the purpose of paying government's creditors in foreign currency, government would essentially have to buy back its own foreign exchange. These unnecessary costs incurred by government could be avoided if all government external funds were counted as part of the Consolidated Fund. The current practice of maintaining MDA accounts outside the Consolidated Fund is a violation of the Financial Administration Decree and the Bank of Ghana Law. The fiscal implication of this trend is that government expenditures rise unnecessarily and this represents an inefficient use of government resources. The additional cost imposed by this practice runs into the hundreds of millions.

Lax Oversight Controls over Export Retentions

A build-up in the nation's foreign exchange reserves reduces the need to borrow from external sources to meet external payments obligations. External borrowing increases domestic expenditures by increasing debt service obligations of the nation. Section 29 of the Minerals and Mining Law, 1986 PNDCL 153 allows a holder of a mining lease to retain in an external account not less than 25 percent of his/her foreign exchange earnings for the purchase of inputs and other related expenses. The external account shall be held in trust on behalf of the holder by a trustee appointed by the holder, with the consent of the Bank of Ghana. The law however, sets a minimum proportion of 25 percent of export proceeds without setting a maximum ceiling. In effect, the holder of a mining lease can retain all

of his/her earnings in an external account. Indeed in 1998, Precious Minerals Marketing Company (PMMC) and Ghana Consolidated Diamonds (GCD) retained 100% of the total foreign exchange from their gold exports. With respect to diamond, the Reports indicated that export proceeds were wholly retained by exporters, and no portions were sold to BOG for cedis. Arguably, the law allows for too much discretion on the part of leaseholders in determining the ceiling, and makes it difficult to make reliable projections of the amount of foreign reserves retained in the country.

The Reports also indicated that contrary to the spirit of the law, the BOG was neither involved in determining the levels of retention of mineral proceeds nor the bases of the retentions. In other words, the determination of the actual quantum of foreign exchange earnings that formed the basis for applying the 25 percent or more retention rate, requires some oversight. The BOG however, was not involved in this process. This trend has obvious implications for government's earnings from gold exports.

Conclusions

The findings of the Auditor-General's Reports indicate that there is considerable scope for government to reduce its expenditures and increase its revenues through more effective management of its limited resources. Some of these changes do not necessarily require more resources, but simply a will to enforce existing policies and to change policies that appear to be detrimental to the interest of the economy. The Auditor-General's Reports contain a wealth of information and policy recommendations that have consistently been either overlooked, dismissed, or taken lightly. The time has come for the Reports to be taken seriously to avoid the pitfalls of the past.

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Note: Nothing written herein is to be construed as necessarily reflecting the views of the Institute of Economic Affairs.