

# LEGISLATIVE ALERT

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## THE 1999 BUDGET: WHERE IS THE VISION?

by

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Although the macro-economic indicators provided in the 1999 budget generally point to an improving macro-economic environment, the budget also reveals how far the Ghanaian economy is, from achieving the targets outlined in the Ghana-Vision 2020 document and the First Medium Term Development Plan (FMTDP). Furthermore, there is an obvious inconsistency between the targets stipulated in the budget and the corresponding targets in the various Vision 2020 documents. These disparities may reflect a divergence of goals and objectives between the bodies responsible for the two documents. To the extent that this is the case, it undermines the relevance of the Vision 2020 document.

### **Overview of the Budget**

On the macro-economic front, the 1999 budget statement portrayed a surprisingly resilient economy that withstood the East Asian crisis and a drought-related energy crisis to record a 4.6 percent overall growth rate. In particular, the economy experienced an impressive performance by the agricultural sector, which grew at a sizzling

5.3 percent rate in obvious defiance of the near drought conditions. The balance of payments overall surplus in 1998 was approximately 300 percent higher than in 1997 on account of capital inflows. Both the trade and budget deficits declined, as did the rate of depreciation of the cedi, interest rates, inflation and the rate of money supply growth. On the other hand, both the external debt and the ratio of the current account deficit (excluding official transfers) to the GDP deteriorated between 1997 and 1998. In addition, although the exchange rate was stable in 1998, the appreciation of the real exchange rate indicated that the nominal exchange rate was inconsistent with the macro-economic fundamentals. In effect, the nominal exchange rate was overvalued.

The negatives notwithstanding, the macro-economic trends generally point in the direction of macro-stability and, in the long run, an enabling environment for private sector development.

However, it is important to note that the quoted figures are provisional. The relevance of this

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distinction is that in the past, the actual figures have varied significantly from the provisional data and for the most part, the provisional figures have been revised downward as opposed to upward. Since 1995, actual GDP figures have been on average approximately 1 percentage point (more exactly, 0.7 percentage point) lower than the provisional figures. In effect, it is very likely that economic performance in 1998 was lower than the performance in the previous year. This would be more consistent with expectations since 1998 was bedeviled by several exogenous shocks.

**Table 1: Growth Rates of Selected Indicators**

	1995		1996			1997			1998	
GDP	- 4.5p	4.0a	5.0t	5.2p	4.6a	5.5t	5.1p	4.2a	5.6t	4.6p
Agriculture	- 4.2	3.7	4.5	4.0	5.2	4.3	3.3	4.3	4.3	5.3
Industry	- 3.3	4.1	3.0	4.2	4.8	4.9	5.7	6.4	6.0	2.5
Services	- 4.9	4.7	5.9	6.3	4.2	6.5	6.2	6.5	6.0	6.0

Source: 1995-1999 Budget Statements of the Government of Ghana; - t—target; p—provisional; a—actual

Most importantly, the positive macro-economic performance must be placed in the context of the Ghana-Vision 2020 policy framework and its related documents (i.e., the First Medium Term Development Plan (FMTDP), and the Programme of Actions (PA), which outline specific steps needed to achieve the long term objectives of Ghana-Vision 2020. Specifically, to what extent are the current economic performance and the objectives stipulated in the budget consistent with the objectives outlined in the Ghana-Vision 2020 document? To the extent that the economy is off-pace, what needs to be done to bring it back on track?

To address these issues, this paper evaluates the real GDP growth targets outlined in the First Medium Term Development Plan (FMTDP) with respect to their feasibility, and then attempts to reconcile the policy initiatives in the budget with the strategies articulated in the FMTDP to realize

those targets. It must be stressed, however, that the task of comparing the Vision 2020 targets with actual performance is fraught with several difficulties because of the multiplicity of targets provided in the various documents.

Indeed, the real GDP growth targets vary from a range of 5.5-6.7 percent in 1999 to a range of 6.0-7.1 percent in the year 2000. With the exception of 1998, the lowest targets are those provided in the 1999 budget statement while the highest targets are contained in the FMTDP.

**Table 2: Growth Targets in the 1999 Budget, The Medium Term Programme of Actions and the First Medium Term Development Plan**

Year	GDP Growth Targets	Agriculture	Industry	Services	Inflation
1998pa	4.4	2.6	4.6	5.7	15.0
1998b	5.6*	4.3*	6.0*	6.0*	9.5*
1998mp	6.1	-	-	-	-
1999pa	-	-	-	-	-
1999b	5.5	5.6	6.3	5.3	11
1999mp	6.7	-	-	-	-
2000pa	7.0	4.5	8.4	7.9	8
2000b	6.0	5.2	6.7	6.3	6.3
2000mp	7.1	-	-	-	-

Sources: 1999 Budget; FMTDP 1997-2000; Programme of Action for the First Medium Term Development Plan (1997-2000)

Notes: pa—Programme of Actions Document, b—Budget 1999; mp—First Medium Term Development Plan.\*Provisional

The obvious question is: why are the budget targets for 1999 and 2000 so different from the corresponding targets in the FMTDP document? There are at least two possible reasons for this development.

First, the budget targets could reflect a downward revision of expectations and a consensual agreement on the part of the National Development Planning Commission and the Ministry of Finance to revise their targets in the light of unexpected exogenous developments.

- the adoption of prudent fiscal and monetary policy measures to ensure stability in domestic prices, interest rates, the exchange rate, and wages;
- promoting private investment as the engine of growth while ensuring that the public sector will provide a facilitating environment for the private sector;
- raising the level of domestic savings to support private sector investment through active mobilization of financial resources.

### Macro-Environment

Although the macro-environment has improved significantly since 1992, the levels of several key indicators such as lending interest rates and the rate of inflation are still too high to stimulate private sector investment. Invariably, significant improvements in real GDP growth cannot occur in a climate of stifled investment and low savings. Higher levels of savings and productive investment are a *necessary* (although not a sufficient) condition for growth. However, between 1995 and 1998, Investment/GDP ratios declined from 20 percent to 18.9 percent.

The FMTDP concluded that the projected GDP growth rate of 6.0-7.1 percent in the year 2000, could be supported by an Investment/GDP share of 20 percent. During the 1995-1998 period, however, the average GDP growth rate of 4.35 percent was associated with an average Investment/GDP ratio of 19.5 percent. In this context, a 6 percent growth rate is more likely to be associated with approximately a 27 percent Investment/GDP share. In the absence of adequate levels of productive investment, it is unlikely that the country can be transformed from an agrarian economy to an industrial economy by the year 2020.

In effect, higher levels of investment and efficiency are necessary to increase agricultural and industrial productivity, and reduce agriculture's share in the GDP to the FMTDP target of 38 percent (1975 constant prices) by the year 2000. At the current share of 40.1 percent, however, this objective is unlikely to be realized.

Furthermore, domestic savings as a proportion of the Gross National Product is on the decline. Correspondingly, the relative share of consumption has been on the rise; it reached a high of 96.7 percent in 1997. Invariably, low domestic savings must be offset by increased foreign savings if investment levels are to be maintained or increased. Within the context of Vision 2020, however, increased dependence on foreign loans implies that the realization of the GDP growth targets will be contingent on sustained inflows of foreign savings. This adds another dimension of uncertainty to the realization of the Vision 2020 targets.

### Budgetary Allocations and Policy Initiatives

What specific proposals are stipulated in the budget to promote sectoral growth through increased private sector investment and development? One can address this question by identifying specific policy proposals targeted at promoting private sector investment in agriculture and industry, and also by the amount of resources devoted to achieving the same objective.

The 1999 budget marks the first year in which the Medium Term Expenditure Framework budgeting system is being used. The budget is broken into discretionary and non-discretionary spending, instead of recurrent and capital spending. Discretionary spending is further broken into five categories under which specific Ministries, Departments and Agencies (MDA's) are classified.

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On the other hand, it could signal a failure to communicate between the two bodies. The former possibility is not unusual since projections and targets are not sacrosanct and do get revised. However, the problem here is the lack of transparency since the rationale for the change was not explicitly communicated to the public. Invariably, a downward revision delays the process of achieving the Vision 2020 goals within the projected time-frame unless offsetting mechanisms and policies are implemented to make up for lost time.

The possibility that the targets stipulated in the budget and the FMTDP reflect separate visions poses a more serious problem. This is because the policies and initiatives outlined in the budget will most likely be inconsistent with the FMTDP document or, if consistent, may not be geared toward achieving the Vision 2020 objectives within the stated time-frame. Furthermore, it undermines the importance and relevance of the FMTDP document, and casts doubt about the usefulness of the Ghana-Vision 2020 document since the budget statement is ultimately the document that drives the economic process.

Operating on the assumption that the disparities in targets reflect a downward revision of expectations regarding economic trends, this paper addresses the following questions:

- Are the “revised” growth targets achievable within the 1997-2000 period? If not, what are the constraints in achieving these targets?
- To what extent are the budget proposals consistent with achieving the growth targets? Specifically, what are the budget initiatives to promote agricultural and industrial growth through private sector development?

#### **Are the Real GDP Growth Targets Achievable?**

It is important to stress that the downward revisions of the growth targets place greater pressure on the economy to over-perform in subsequent years if the economy is to achieve middle-income status by the year 2020. Nonetheless, achieving the relatively

modest growth targets of 5.5 percent and 6.0 percent in 1999 and 2000, respectively, may be problematic for the following reasons. First, real GDP growth averaged only 4.35 percent during 1995-1998, and has not increased by more than 1 percentage point since 1993. Thus, significant increases in productivity will be necessary for achieving the stated goal.

Second, exports account for approximately 25 percent of the GDP and the bulk of our foreign exchange earnings. However, only three primary commodities (gold, timber, and cocoa) account for the majority of our export earnings. Indeed, these three commodities are expected to generate 78 percent of export receipts in 1999. Yet, projected trends in commodity prices for two of these products, i.e., gold and timber, are not optimistic and, although non-traditional exports have assumed a growing share of the export basket, they still account for less than 15 percent of total exports. Consequently, the contribution of traditional exports to export earnings will most likely decline in 1999 unless lower commodity prices are offset by increases in production.

Third, to the extent that the agricultural sector contributes almost 40 percent to the GDP, accelerated growth will require substantial improvements in the productivity of this sector in particular. Specifically, the fisheries, crops and livestock sub-sectors will need to grow at significantly higher rates than the 1995-1998 average of 3.6 percent, to offset likely declines in the value of Ghana’s traditional exports.

Fourth, given the unhealthy dependence of the agricultural sector on rains, any hopes of realizing the 5.5 percent growth target must be predicated on the assumption of favorable weather conditions.

In particular, substantial improvements in agricultural and industrial productivity will require at least two critical elements: an enabling macro-environment and a vibrant private sector. Indeed, in recognition of this fact, the FMTDP document explicitly adopted macro-economic strategies to achieve these objectives. The strategies include:

Table 3: Shares of Discretionary Spending by Category

	Total (¢ billions)	1999	2000	2001	1999- 2001
General Admin.	¢2,887	26.89	-	-	23.0
Finance	¢392.9	3.1	2.99	3.27	3.1
Economic Services	¢1,269	10.30	-	-	10.1
Food & Agric	¢411	3.46	3.20	3.2	3.27
Trade & Industry	¢47.6	0.43	0.35	0.36	0.38
Tourism	¢17.6	0.13	0.14	0.15	0.14
Science & Tech	¢27	1.73	1.75	1.9	1.8
Lands and Forestry	¢227	1.13	1.13	1.25	1.17
Mines & Energy	¢418.5	3.45	3.27	3.28	3.33
Infrastructure	¢3,019	21.2	-	-	24.01
Social Services	¢3,905	30.4	-	-	31.06
Employment	¢45	0.37	0.34	0.37	0.36
Sports and Youth	¢58.9	0.58	0.40	0.44	0.47
Education	¢2,481.2	19.92	18.99	20.28	19.73
Public Safety	¢1,360	10.81	-	-	10.1
Contingency		1.1	-	-	1.1

Source: 1999 Budget Statement

According to the budget statement, the broad objectives of the economic services sector include expanding the productive base of the economy to make industry competitive; increasing agricultural production and investments to ensure food security; establishing a strong national scientific and technological base for accelerated and sustainable development; and promoting tourism. However, the budgetary allocations do not reflect the importance of these objectives.

To boost foreign exchange earnings and promote domestic price stability, more funds should have been geared toward export diversification, food production, tourism as well as science and technology. Greater investments in science and technology promote innovation, which is critical for increasing productivity in the key sectors of agriculture and industry. Increased investments in tourism, a potentially lucrative source of foreign exchange, will diversify our sources of foreign exchange earnings, reduce our dependence on traditional exports, improve our current account balance, and create employment and growth.

In their present configuration, the budget priorities may not be sufficiently growth-oriented to achieve the growth targets. Moreover, the allocations do not appear to give priority to private sector development beyond policy measures to create an enabling environment. In contrast, the PA conceded that "apart from the creation of a conducive enabling environment to facilitate private sector development, specific economic incentive packages are needed as further prerequisites to pro-actively induce the private sector to act as an engine of growth."

Specifically, the document expressed the need for "a clear-cut industrial policy, and concrete financial steps to facilitate private sector access to long-term investment finance for prioritized sub-sectors of industry and agriculture..." [p. 9, paragraph 42]. However, the budget proposals provide few initiatives to increase private sector access to long-term credit. Specific proposals in this direction include the following:

- A legislative instrument on mutual funds and unit trusts will be laid before Parliament before the end of March 1999;
- The exemption on capital gains tax on securities traded on the Ghana Stock Exchange will be extended;
- *Five billion cedis* will be set aside to revitalize cooperative production and marketing societies, to facilitate access to credit and raise agricultural production;
- The Youth in Agriculture Programme will receive *¢5 billion cedis* to support young people in the production of selected crops;
- The tax payable by banks on incomes derived from lending to the agricultural sector will be reduced from 35 percent to 20 percent;
- The *proposed* establishment of the Export Development and Investment Fund.

These initiatives may be too little to generate significant private sector response, especially when one takes into account the potential crowding out effect of government arrears and unattractive lending rates. In particular, the effectiveness of The Export

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Development and Investment Fund, which is a credit guarantee scheme for exporters, is likely to be compromised by a combination of two factors: high lending rates and an overvalued nominal exchange rate. An overvalued exchange rate undermines export competitiveness by raising the foreign currency price of exports, while high lending rates increase production costs relative to our trading partners.

With respect to the *perennial* problem of arrears owed to contractors, the government has promised to address the issue by reviewing some of the major road-works. However, the nature of the review was not explicitly stated. To the extent that contractors have satisfied their contractual obligations, it is not clear why a review is necessary. Meanwhile, continued delays in arriving at solutions, stifle private sector liquidity and investment and consequently, undermine the country's chances of achieving middle-income status by the year 2020.

Finally, even though the FMTDP projects a decline in the population growth rate to 2.9 percent by 2000, the budget is silent on policy initiatives to reduce population growth. To the extent that middle-income status is defined in terms of per capita income, higher growth rates will not get the economy any closer to achieving middle-income status if the rate of

population growth is not reduced. The need for urgency in addressing the population growth problem is underscored by the fact that population control measures have a long gestation period; hence, delays in their implementation will certainly have adverse consequences for our per capita incomes in the future.

### Conclusions

Although the macro-indicators provided in the budget are pointing in the appropriate direction, double digit inflation and interest rates are a disincentive to private sector investment in agriculture and industry. Furthermore, expenditure allocations for economic services outlined in the 1999 budget, are not consistent with the growth targets of the Vision 2020 document. Correspondingly, policy initiatives to increase access to long-term investment credit do not provide adequate funding mechanisms to make the private sector the engine of growth as envisaged by the architects of Vision 2020. Most importantly, the budget is silent on measures to curb population growth and insure that higher growth rates translate into higher per capita incomes in the future. This oversight places a greater development burden on the real growth rates, which have to increase at a much faster pace than population growth rates to ensure any improvements in per capital income.

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