Institute of Economic Affairs (IEA)

COMMENTS ON THE MID-YEAR REVIEW OF THE 2021 BUDGET

Delivered at a Press Conference
Tuesday, 3rd August, 2021
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1. General Comments

On Thursday, 29th July, the Minister of Finance presented his Mid-Year Review of the 2021 Budget to Parliament in satisfaction of a constitutional requirement. Normally, the Minister would say that his revenue and/or expenditure estimates have changed and that this would require higher or new taxes and/or higher expenditure or appropriation, as they call it. That would have required parliamentary approval. However, the Minister said he was not asking for additional expenditure or appropriation. Neither was he proposing any tax changes. As such, the budget review did not require Parliamentary approval. Both sides of Parliament agreed that members could only exercise their right to comment. The presentation was essentially a rehash of the 2021 budget.

We observe that the aggregate level of revenue and expenditure remained the same. This is bit puzzling, though, because the 2021 budget was presented as far back as November last year and since then changes in the economy were expected to affect the original estimates. The binding constraint on the Minister as far as the execution of the budget is concerned really is the level of expenditure or appropriation. If in the end, he gets more revenue but keeps to the approved expenditure, he would not have breached the Parliamentary appropriation. He will end up with a lower deficit and lower borrowing. If he gets less revenue and still spends the approved expenditure, he would not have breached the Parliamentary appropriation. He will end up with a higher deficit and higher borrowing. The part of the additional borrowing that is external would, however, require parliamentary approval.

The review does not contain macroeconomic and budget estimates for the medium-term so one can assume that they remain the same as in the 2021 budget. We would like to comment on the following areas: i) economic growth, ii) revenue performance, iii) revenue allocation, iii) the budget deficit, iv) debt, v) employment policy, and vi) economic transformation policy, because we attach great importance to them. The budget is a very big document, so one can only be selective in commenting on it. The selection of what is important is really subjective.

2. Economic growth

The 2021 budget, which was presented in November, estimated growth of 0.9% for 2020. According to the Minister, the turnout was 0.4%, indicating that the effect of the Covid-19 pandemic was probably severer than originally anticipated. Even this lower growth was much better than what was experienced around most of the world, due to severer episodes of the pandemic or poorer management of the situation.

The budget review does not contain medium-term growth projections as the 2021 budget itself did. The Minister maintained the GDP growth of 5.0 projected for 2021 in the November budget. While this is relatively high, it must be seen as coming from a low GDP base in 2020. We are more concerned about the medium-term (2021-24) growth estimates, which average 5% annually. We maintain that as a developing country with abundant untapped natural and human resources and excess production capacities, we should be able to leverage these resources and capacities so that we can grow faster and deliver our people out poverty more quickly.

3. Revenue performance

Revenue mobilization still remains a serious challenge in Ghana. But this challenge is not totally unsurmountable. We only have to do things a bit differently, as continuing to do the same things would not give us different results. The tax revenue and total revenue projections for 2021 are about GHc56 billion (US$9.7 billion) and GHc72 billion (US$12.4 billion) respectively. These are peanuts, to say the least! In GDP terms, the tax and total revenue are 12.7% and 16.5% respectively. These ratios compare unfavourably with our middle-income peers' average of 25% and 30%. Ghana's personal income, corporate income and indirect tax rates are relatively high. Therefore, our low revenue effort is not due to the fact that our tax rates are low. It is rather due to the fact that we fail to collect a lot of taxes. Even the Minister reported that during H1-2021, revenue collection fell short of the target by GHc4.1 billion (or12.5%), although he believes that the annual estimate could still be achieved.

We need to increase our revenue effort by widening the tax net and plugging the numerous loopholes. The 2021 budget admitted that tax underreporting and tax evasion abound in the extractives sector, among others. Let us remind ourselves about some of these loopholes that need to be addressed as a matter of urgency:

- We lose revenue in excess of GHc5 billion (or about US$1 billion) annually through tax exemptions. Tax exemptions are, however, subject to considerable abuse. Government enacted a bill to streamline the exemptions, but it has been languishing in Parliament since 2019. The political will to pass the bill seems to be lacking, ostensibly due to entrenched interests. Parliament needs to do the needful in passing the bill with urgency to plug a big hole in the tax system.
- Property taxes constitute potentially a large pool of revenue, given the sprawling mansions in the urban areas, but they are barely collected. A full inventory of properties need to be undertaken so that market-rate taxes can be levied appropriately. Making property tax collection the responsibility of MMDAs and allowing them to retain part as their internally-generated funds, would be a good step to boost property taxes.
- Substantial amount of revenue is lost through illicit financial flows, such as trade mis-invoicing, transfer pricing and various forms of money laundering. Studies put annual revenue loss from illicit financial flows at about US$3-4 billion. A strong investigative and surveillance system is needed to detect and curb these practices. Equally needed is a strong sanctions regime to punish and deter culprits.
- Tax evasion or noncompliance, which often occur with the connivance of tax officials, and is quite prevalent in the professions space, represents a major source of revenue

loss to the state. A strict surveillance system backed by a strong sanctions regime is needed to deter and minimize the incidence of tax evasion.

- The informal sector accounts for 30% of GDP, yet a large part remains outside the tax net. Most of the activities are small in scale, but cannot be completely ignored. Businesses that employ at least a few people, like mechanics, hairdressers, tailors and other artisans, should be taxed, while leaving out small fishes like "kayayoos," "kenkey," "waakye,"and "ice-water" sellers, who have tiny incomes. Digitization and other new technologies should be fully leveraged for collection of informal sector taxes.
- Tax fraud and corruption perpetrated through connivance between tax payers and tax officials deprive the state of substantial revenue annually. We suggest that a strong multi-layered surveillance system supported by automation and digitization be used to deal with the problem, in addition to a strong sanctions regime to deter and punish offenders.
- Inefficiencies still persist in tax administration, including collection delays, inadequate taxpayer coverage and high collection costs, which result in revenue losses to the state. Expanding automation and digitization would go a long way to improve efficiency in tax administration and positively impact on tax revenue.

Experts estimate that plugging these loopholes could add over 10% of GDP to our tax revenue collection. The Minister stated that enforcing compliance and plugging tax loopholes will be the key vehicles for achieving revenue targets. However, often we pay lip service to these measures without really acting on them, ostensibly due to political considerations. In any case, we do not see these planned measures factored into higher revenue targets. We need to act with urgency to scale up our revenue otherwise expenditure may be constrained and/or the deficit and debt will escalate. Further, the economy would be constrained to a low growth path, thereby perpetuating our underdevelopment and impoverishness.

4. Revenue allocation

While we do not collect enough revenue, we allocate what we collect also poorly or inefficiently. In 2021, total expenditure is estimated at GHc114 billion (about US$19.7). This is not a lot of money either, given all our needs. We have argued that Ghana's level of expenditure, in and of itself, is not excessive. In fact, in GDP terms, the 2021 expenditure is 25%, which is much less than the middle-income countries' average of about 35%. The problem is that our expenditure is constrained by our equally low revenue effort, since the budget deficit has to be contained somewhat. A major problem with our relatively small expenditure is that it is grossly skewed in favour of recurrent expenditure and at the expense of capital expenditure (CAPEX). In 2021, recurrent expenditure is estimated to be GHc109.9 billion (or 20% of GDP), while CAPEX is about GHc17.6 billion (or 4% of GDP). The level of CAPEX is unacceptably low. Indeed, as a developing country, we should be allocating 10-15% of our national income (GDP) to CAPEX. That is what will allow the economy to grow rapidly and move the country up the development ladder quickly enough.

Recurrent expenditure is dominated by compensation and interest. In 2021, compensation is GHc31.5 billion (or 28% of total expenditure), while interest is GHc32.5 billion (or 29% of total expenditure). In terms of tax revenue, compensation accounts for 58.3% and interest 56.4%. Together, compensation and interest account for 115% of tax revenue. The implication is that tax revenue cannot even fund compensation and interest. Certainly, serious expenditure rationalization and rebalancing is called for.

- Compensation needs to be reined in by streamlining the entire public sector that depends on the public pay roll—i.e. civil service, MDAs, office of government machinery, Article 71 office holders, etc., etc. There is evidence of a bloated public sector with duplicative functions in some instances that need to be addressed.
- Statutory funds—GetFund, DACF, Road Fund, NHIF, etc—should be reformed to improve their efficiency and make them more fit for purpose.
- A comprehensive debt management strategy, including restructuring and buybacks, should be undertaken to rein in interest payments and their burden on the budget. But curtailing the budget deficit is the way to rein in debt service on a durable basis.
- There is always room to streamline and contain MDAs' expenditure on goods and services, so as to reduce the burden on the budget. Current exigencies require austerity in spending across all MDAs.
- Most importantly, CAPEX should be scaled up significantly from its current level of 4% of GDP to at least 10-15% over the medium term to support higher growth.

5. Fiscal deficit

The fiscal deficit is kept at the same level of about 9.5% as in the 2021 budget. It is, however, not known if this figure includes the energy and financial sector costs or not. Government and the opposition have argued noisily about whether reported deficits include or exclude these costs. The costs are undoubtedly government expenditure and should be classified as such. If, however, government feels that they are "unusual" expenditures, they are entitled to say so. However, fiscal transparency and credibility require that these costs are properly accounted for. They can be included in the deficit with an asterisk explaining their inclusion. On the other hand, they can be excluded from the deficit and shown as a separate line item so that if anyone wants to add them to the deficit, they can do so. The same treatment should be accorded the debt. This will prevent the constant unproductive arguments between government and the opposition regarding the true level of the deficit—and debt. Covid costs have further compounded the effect of the energy and financial sector costs on the deficit—and debt.

The Minister stated that it will take up to 2024 to return the deficit back to within the Fiscal Responsibility Law ceiling of 5%. But if we increase efforts to scale up revenue while containing expenditure, then it should be possible to bring this target date even forward. As we explain below, the deficit levels are an important determinant of the debt trajectory.

6. Public debt

The Minister reported the public debt as of end-June 2021 to be GH334.6 billion (or 77.1% of GDP). He said the figure includes the energy and financial sector costs. The comparative figure for 2020 was stated as GHc291.6 billion (76.1% of GDP); 2019, GHC218.2 billion (62.4% of GDP); 2018, GHc173.1 billion (57.6 % of GDP); 2017, GHc142.5 billion (or 55.5% of GDP); and 2016, GHc122.2 billion (or 56.8% of GDP). It is not stated, however, whether these figures include any energy and financial sector costs or not. This should be clarified. Neither the 2021 budget nor the mid-year review has medium-term debt estimates. But we know that borrowing to finance the medium-term deficits in the 2021 budget will elevate the debt trajectory.

There is the nagging question as to whether Ghana is facing a debt crisis or not. The opposition says there is a crisis and that Ghana must seek debt relief from the IMF. Government has dismissed this claim and says it is not going to the IMF anytime soon. The fact is that the debt-to-GDP ratio has since 2019 exceeded the 70% that is generally regarded as the sustainability threshold for middle income countries of which Ghana is one. Of course, the ratio has gone up further in 2020 and 2021, to a large extent on the back of Covid costs, and may remain above the threshold for several more years. The IMF has described Ghana as having a high risk of debt distress (*2021 Article IV Consultation*), although it regards the debt profile to be still manageable. So, the IMF, on its part, has not made a case yet for debt relief for Ghana.

But, the fact is that your debt itself may not pose immediate financial burden because you do not have to pay it all today. It can wait for future generations. The immediate financial burden, however, is the cost of servicing the debt or the interest payment. As we stated above, in 2021, we will be using as much as 56% of our tax revenue to pay interest on our debt. And the ratio could rise over the medium-term, especially if we stick to the unambitious revenue targets. Interest payments could actually swamp the budget in the coming years if appropriate measures are not taken. While, as we suggested above, a comprehensive debt management strategy could help bring some relief to the debt service burden, raising revenue while containing non-capital expenditure, is the best way to ease the financial burden of debt service on a more durable basis.

7. Employment policy

The Minister duly recognized the challenge that unemployment continues to pose to national development, with youth unemployment, in particular, being very acute. He reported that the 2019 GLSS estimated overall national unemployment rate at 8.4 percent and that of the youth (i.e. 15-35 years) at 12.6 percent. These estimates, however, appear quite conservative. Evidence on the ground would seem to suggest that unemployment and underemployment rates are much higher. A high rate of unemployment is worrisome because it limits economic opportunities for the unemployed, constraints overall growth of the economy and creates social instability.

The budget contains a plethora of government-originated employment schemes largely targeted to the youth. While these schemes may be well-intentioned, it is important to coordinate them properly to reduce duplications, costs and inefficiencies. The skills training components of the schemes are particularly important because they promise to equip the youth to be more suited for the labour market. The proposed National Unemployment Insurance Scheme and Training/Retraining Programme are important initiatives in terms of providing temporary income support to workers who lose their jobs through unanticipated events, while also equipping the unemployed to increase their chances of securing jobs. The training programmes should also equip the unemployed to be able to set up their own enterprises as the labour market cannot absorb them all.

It has to be pointed out that states, by their nature, cannot provide quality, permanent jobs to the unemployed. Further, state employment schemes—and the emoluments that come with them—can distort the labour market since they are not usually governed by labour supply and demand factors. The state must focus more on policy interventions that create balanced growth in the economy and also support the private sector to grow and create jobs. It is, therefore, noteworthy that, in this regard, government recognizes the relevance and importance of economic transformation and industrialization policies that can stimulate the economy. Government, also, recognizes the importance of creating the enabling environment for enterprises to thrive and create jobs. As always, concretizing these intentions remains the challenge that needs to be overcome.

8. Economic transformation policy

The Ghanaian economy has retained virtually its “colonial structure” 64 years after independence, still exporting extractives and other primary commodities. Because these commodities are exported in raw, unprocessed form, they fetch low prices on international markets, where Ghana is a price taker, and render the economy vulnerable to terms-of-trade shocks. The Ghanaian economy needs to be transformed into a modern, resilient and self-sufficient one. While this need has long been recognized, we have largely paid lip service to it and real actions to that end have rather been tepid. A strong economic transformation drive is necessary to propel the country from third-world to first-world status in a generation. Three areas that we see in the budget as key for transformation of the economy are: i) agriculture and agri-business, ii) industry and technology, and iii) digitization. And we wish to take the opportunity to offer brief comments on them.

Ghana is still predominantly an agrarian economy, with agriculture employing over 60% of the labour force. Agriculture remains our major resource. Economic transformation, therefore, must necessarily involve—or even start with—agriculture. The problem with agriculture is that productivity is low due to a plethora of shortcomings, including: continual use of simple farm implements; inadequate mechanization and application of modern scientific methods; reliance largely on rain-fed agriculture with limited irrigation facilities; inadequate high-yielding seed varieties; inadequate quality extension services; and high cost of credit. In addition to these production bottlenecks, agriculture also faces inadequate storage and preservation facilities, leading to high post-harvest losses, and inadequate markets. The budget recognizes these shortcomings and proposes measures to address them. We urge that the measures should be followed through to modernize and improve agricultural productivity while also supporting agri-business and the entire agricultural value-chain.

Industrialisation is key for the rapid transformation of Ghana from a developing country to a developed one. Unfortunately, Ghana is less industrialized today than it was in 1970, with manufacturing output as a ratio of GDP dropping by about a third from 15% to 10%. This is the result of the policy over the years to privatize several state-owned enterprises built by President Nkrumah, while local private businesses have been suffocating under the weight of numerous obstacles. As a result, Ghana depends heavily on imports, which deprives us of jobs locally and puts pressure on our currency. The de-industrialization of the country over 60 years has stifled the growth of the economy, growth in living standards and our fight against poverty. Ghana also has a huge technology deficit in all important areas, such as agriculture, industry, medicine, health, education, energy, and natural resource exploitation. This has led to our over-dependence on foreign technology, which takes away a lot of our resources and also makes us vulnerable. Our research and academic institutions have not helped in the local development of technology because they have faced inadequate resources and facilities coupled with inappropriate curricular and deficient tutoring, among other impediments. The budget proposed important initiatives for reinvigorating industrialization and developing local technology, including: i) adding value to agricultural products; ii) support for pharmaceutical factories; iii) support for the machine tools industry; iv) support for R&D in education and research institutions; and v) building of regional industrial parks. We want to reiterate the importance of leveraging our comparative and competitive advantages in natural resources in the form of arable land, minerals, oil and gas, to spur industrialization, including in petrochemicals, textiles, agro-products, chocolate, aluminium and steel, among others, for transformation of the economy.

The budget places due emphasis on digitization as another vehicle for transforming the economy and indicates several initiatives in that regard, including the National ID system, digital address system, interoperability of payment systems and the Ghana.Gov Platform. Ongoing digitization of public services, including driver's license and vehicle registration, motor insurance database, online application for passports, paperless port systems, and renewal of the National Health Insurance Scheme (NHIS) membership will contribute to improved service delivery and increase efficiency. Additionally, formalization of the economy through digitization has numerous potential benefits, including in the areas of personal identification, taxation and the fight against corruption.

5. Conclusion

The 2021 budget and the mid-year review face the difficult task of responding to the health and economic impact of the Covid-19 pandemic, while restoring the economy to sustainable growth. Because of the scaled-up government interventions to save both lives and livelihoods, financial imbalances have further escalated. We should be increasing our efforts to raise more revenue by pugging the numerous loopholes in the tax system. This is also the time for serious expenditure rationalisation by curtailing recurrent expenditure to the extent possible to create space for more investment expenditure to spur economic growth. The lack of sufficient ambition in scaling up revenue and the similar lack of the will to rationalise expenditure have contributed to higher financial imbalances while constraining economic growth. We have been too slow in moving the country forward 64 years after independence. We need to take bold, innovative and ambitious measures to achieve the necessary quantum jumps in our development indicators so that we can lift our people out of poverty within a generation. The opportunity should be seized to redirect the budget projections to this end, while implementing transformative policies to accelerate the development of this country.