First Review of Ghana's Three-Year Financial and Economic Program
<u>Under the IMF Extended Credit Facility, 2015-2017</u>

A mission team from the International Monetary Fund (IMF) conducted its first review of the country's three-year ECF-supported program from mid- to late-June 2015. At the end of the review, the Leader of the Mission Team, Mr. Toujas-Bernate, issued a Press Statement to the following effect:

- *The program is on track, with all performance criteria met <u>except for the ceiling on central bank financing to government which was technically missed by a small margin</u>. The mission welcomes <u>the commitment reiterated by the authorities to the ambitious fiscal consolidation and structural reform program</u>, in particular <u>addressing payroll irregularities, enhancing public finance management and transparency and liberalizing the oil distribution sector</u>.*

- *Good revenue performance and the containment of the wage bill and other spending as programmed contributed to this outcome. <u>No new arrears were accumulated</u> for the review period and <u>past arrears were repaid as planned</u>. With higher projected revenues, the overallcash deficit is expected to be slightly lower than programmed for the year as a whole. Additional revenue above the budget projections will help cover additional spending related to <u>the recent flooding and larger arrears clearance, as additional arrears as of end-2014 were identified in audits</u>.*

- *Budget support from development partners (particularly the additional amount equivalent to USD 150 million from the World Bank) should also reduce pressures on the foreign exchange market and allow the central bank to rebuild its reserves to "a higher level than programmed by year-end".*

- *Economic growth in 2015 is expected to remain broadly as expected (at 3½ percent), <u>with low cocoa</u> and gold production but increasing hydrocarbon production.*
  [Statement at the Conclusion of an IMF Review Mission to Ghana; Press Release No. 15/307, June 30 2015; emphasis added].

CEPA's assessmentcontained in Table 1 below is broadly in line with that of the IMF. In the Press Release, the staff noted that the IMF Executive Board is tentatively expected to consider the review in August, following finalization of the required documentation. However there are some concerns which may relate to the need for this required documentation.

CEPA's crude estimates of the primary fiscal balance of the government, which is set as a floor in the program, is surprisingly rosy — a mirage of over-performance that points to possibilities of some primary expenditures not having been paid for within the review period. This situation is not only unfortunate but also unnecessary, as it could have conceivably resulted in some arrears accumulation, the amount and size of which has been difficult to determine by CEPA during the review period.

The second quantitative criterion, the ceiling on the public sector wage bill, was evaluated by CEPA to have fallen below the target set in the program by some GHS179 million. This implies that the ceiling was not breached and therefore the performance of the wage bill in the first review period of the program proved satisfactory.

The third and fourth quantitative performance criteria — the floor on the net international reserves (NIR) of the Bank of Ghana; and the ceiling on the net domestic assets (NDA) of the Bank of Ghana respectively — were assessed by us to have been met satisfactorily. While the realized NIR (excluding foreign currency deposits) was some US$144 million above the floor, the NDA of the Bank of Ghana was estimated by CEPA to have fallen below the target ceiling set in the program by some GHS961 million.In each of these cases, therefore, the quantitative performance criterion was not breached.

In respect of the fifth quantitative performance criterion — the net change in the stock of arrears — the program's expectation is for the clearance of at least GHS424 million of payments arrears by end-April 2015. Crude estimates by CEPA, however, indicate that this ceiling could not be met, as only GHS380 million of expenditure arrears (the equivalent of almost 90 percent of the set target) could be cleared by the end of the review date.

In respect of the first continuous performance criterion of the program, the Fund staff in its Press Statement quite rightly that: the ceiling on the central bank financing to government was "*technically missed by a small margin*" — which is estimated by CEPA to amount to some GHS170 million above the ceiling.

It is important to stress, however, that the ceiling originally set on this continuous performance criterion was in respect of *gross financing of the Bank of Ghana (BoG) to government and state-owned enterprises* (SOEs) without any breakdown into its components whatsoever. Moreover, when disaggregated by the respective components, crude estimates by CEPA confirmed that the ceiling on BoG financing to government was indeed breached; while that on financing to SOEs was some GHS216 million below the target— making up for the estimated GHS170 million financing shortfall to government, and still left with enough funds to not breach the target ceiling on gross financing to both government and SOEs of GHS14.614 billion (as shown in Table 1below).

In CEPA's assessment the entire handling of this particular continuous performance criterion has not only been sloppy, but once again, unfortunate and unnecessary. Our viewpoint is that with proper coordination this situation could have been avoided because the ultimate responsibility of program monitoring and coordination rests with the Ministry of Finance and the Bank of Ghana. These two institutions are expected to perform this role by consulting with the relevant institutions within the Economic Policy Coordinating Committee (EPCC) framework for tracking progress on various targets and reforms under the program. This calls for coordination within the EPCC to be strengthened.

It is also not very clear to CEPA the size and status of new arrears accumulation, especially new domestic arrears accumulation in the review period. An examination of both the historical records and available data in the review period point to:

- delayed transfers to pension funds, including to the Social Security and National Insurance Trust (SSNIT) Fund;

- “grants to other government units”, largely transfers to GNPC and statutory funds — the District Assembly Common Fund (DACF), National Health Fund, Ghana Education Trust (GET) Fund, Road Fund and Petroleum Related Fund.
- Purchase of goods and services — largely of complementary inputs especially for the health and education sectors;
- transfers to groups such as “lifeline” consumers; and
- transfers in respect of the poor and the vulnerable, such as the Livelihood Empowerment Against Poverty (LEAP) and the capitation grant

These have been the usual suspects for domestic arrears accumulation.

CEPA is well aware that the stock of arrears at end-2014 was originally stated at GHS6.24 billion, the equivalent of 5.5 percent of GDP; subsequently, additional arrears were identified in “audits of claims from oil importers and reviews of cross debts among utility companies”. According to the IMF Press Statement of June 30 2015, this would necessitate larger arrears clearance. Our crude estimates show that the country could be falling short in transfers in the context of this larger stock. Ongoing efforts aimed at prompt and active clearance of arrears would therefore need to be stepped up.

With respect to statutory funds the Memorandum of Economic and Financial Policies, 2015-2017 makes reference to the statutory funds being the cause of “*increasing rigidities in the budget and limiting effects on policy maneuvering*”. Specifically, the issue is thatthe rigidity in the budget arises from the existence of a number of statutory funds which receive a fixed share of certain budgetary revenues, and which minimize government discretion on the use of its revenue and also partly leads to a buildup of arrears payments.

This situation is untenable and cannot be sustained. The rigidities have been noted as far back as 2009, with mandatory and inflexible expenditures exceeding 100 percent by end-2009.

> “*The growth of mandatory and similarly-protected spending commitments limits the space for fiscal maneuver. With a rising wage bill, an expansion of health care transfers in 2007, and the majority of capital spending protected from annual budget review (in the form of trust funds with earmarked financing), the inflexible element of the annual budget has risen from 92 percent of revenues and grants in 2006 to 107 percent in 2009*.” [IMF Country Report No. 09/256, August 2009, paragraph 22, page 12]

To the best of our knowledge, transfers to the statutory funds are constitutional provisions mandated in the 1992 Constitution of the Republic of Ghana for developmental purposes. For example, in present circumstances, transfers to the DACF in any given yearare not to be less than 7½ percent of government tax revenue of the preceding year; and were originally intended for domestically financed capital expenditures in all districts in Ghana [Act 252, 1992 Constitution of the Republic of Ghana]. In so far as the funds are used effectively and efficiently for their purposes they cannot be treated as grants or seen as “slush funds”.

Also the indicative target rate for inflation during the review period was missed by 1.4 percentage points, signaling underlying inflationary pressures.

Finally, the IMF Press Statement made reference to the growth rate remaining broadly as expected, with "low cocoa and gold production but increasing hydrocarbon production. Furthermore, it welcomed the authorities' efforts to address the electricity shortages by bringing new private financed power plants to support a rebound in growth,

CEPA is concerned that:

- The release of the first quarter growth rate of the economy may not have considered the seasonally adjusted real growth rate of 5.8 percent at market prices. Both the International Cocoa Organization (ICCO) and the Ghana Cocoa Board (Cocobod) have recently revised downwards forecasts of cocoa purchases for the 2014/15 cocoa season by close to 23 percent, leading to CEPA's concern that the value-added in the cocoa sector may not have been sufficiently factored into the calculation of real GDP growth for 2015. Properly considered, this would mean that non-oil sector growth may even be lower than projected for 2015 by the IMF.

- The recent shutdown of the Atuabo Gas Plant has been a major setback in the production of electricity. The Volta River Authority (VRA) will have to spend USD 50 million to purchase crude oil to power its thermal plants if the supply of gas is not restored. This would further put pressure on the foreign exchange market and forestall the central bank's quest to rebuild its reserves.

Table 1: Quantitative Program Targets

	2014	2015		
	Dec Act.	Apr Prog.	CEPA Est.	Status
I. Quantitative Performance Criteria				
Primary fiscal balance of the government (floor in millions of cedis)	(3,555)	(544)	954	✓
Wage bill (ceiling; in millions of cedis)	9,449	3,413	3,251	✓
Net international reserves of the Bank of Ghana (floor; millions of US dollars)[1]	1,415	1,042	1,186	✓
Net domestic assets of Bank of Ghana (ceiling; millions of cedis)[2]	3,095	5,755	4,794	✓
Net change in stock of arrears (ceiling; millions of cedis)	428	(424)	(380)	X
II. Continuous Performance Criteria				
Gross financing of BoG to the Government and SOEs (ceiling; in millions of cedis)[3]	13,603	14,614	14,568	✓
Non-accumulation of external arrears (ceiling; millions of U.S. dollars)	n/a	n/a	n/a	
Non-accumulation of domestic arrears (ceiling; millions of cedis)	n/a	n/a	n/a	
Contracting or guaranteeing of new external non-concessional debt (ceiling; millions U.S. dollars)	n/a	n/a	n/a	
III. Indicative Target				
Program central target rate of inflation (12 month percentage change)	17.0	15.4	16.8	X
Social Protection (floor, in millions of cedis)	947	388	n/a	

[1] Program definition excludes foreign currency deposits in BoG. Defined as a level

[2] Net domestic assets is computed using the program's exchange rate of GHS 3.40 per US dollar as defined in the attached Technical Memorandum of Understanding (TMU).

[3] Defined as a level