RE: First Review of Ghana's Three-Year Financial and Economic Program under the IMF Extended Credit Facility, 2015-2017

A. Introduction and Background

On the 22nd of July, CEPA published a report titled "First Review of Ghana's Three-Year Financial and Economic Program under the IMF Extended Credit Facility, 2015-2017". The report was CEPA's preliminary assessment of the performance against the Quantitative Program Targets for the first Review (see Request for a Three-Year Arrangement Under the Extended Credit Facility, Staff Report, Press Release and Statement by the Executive Director for Ghana, IMF Country Report No. 15/103, April 2015) – over the first four months of 2015.

Since then more data have become available particularly from the Mid-Year Review of the Budget Statement and Economic Policy and Supplementary Estimates (herein after Mid-Year Review) presented to and approved by Parliament on the 21st July, 2015.

The Revised Budget differs from the Program in three key areas:

- *"With higher projected oil revenues, the overall cash deficit is expected to be slightly lower than programmed for the year as a whole" (see Statement at the Conclusion of an IMF Review Mission to Ghana; Press Release No. 15/307, June 30 2015).* The Revised Budget estimates this lower deficit at 7.3 per cent of GDP instead of the 7.5 per cent of GDP in the Program;

- *"Additional arrears as at end-2014 were identified in audits of claims from oil importers and reviews of cross debts among utility companies" (ibid).* Estimates derived from the Revised Budget raised the ceiling for the net change in stock of arrears for 2015 from GH¢424 million to GH¢643 million in line with the commitment to clear the entire stock of arrears by 2017 possibly at equal yearly instalment; and

- *"Additional spending will be required on account of the recent flooding" (ibid).* This however is not expected to impact on the deficit as the spending will be covered from additional revenues above the projection in the Program over the review period.

The higher projected oil revenue in the Revised Budget is on account of the higher projected average price of US$57 per barrel compared to the US$52.8 per barrel in the Program (see paragraph 202, in the Mid-Year Review). The volume has been kept unchanged at an average of 102,033 barrels per day – equivalent to 37.242 million barrels for the year in the Program (see paragraph 200, p,g 42 in the Mid-Year Review).

The Program's quantitative targets are subject to adjustors. Specifically, the adjustors stipulate that the fiscal deficit would be adjusted "Downward (upward) by 50 per cent of any excess (shortfall) in oil revenue" (see paragraph 28 of the Technical Memorandum of Understanding of the ECF, p.g 83). The lower deficit (7.3 per cent of GDP compared to 7.5

per cent of GDP) referred to above is consistent with the lowering of the deficit in the Mid-Year Review (see Appendix Table 2). As a result of this the target for the primary fiscal balance will also be reduced.

Ghana Quantitative Program Targets (Jan-Apr 2015)

	2014	2015			
	Dec Act.	Apr Prog.	Apr Prov.	Δ(CEPA -Prog)	Status
I. Quantitative Performance Criteria					
Primary fiscal balance of the government (floor in millions of cedis)	(3,555)	(515)	(830)	(315)	x
Wage bill (ceiling; in millions of cedis)	9,449	3,413	3,341	(72)	✓
Net international reserves of the Bank of Ghana (floor; millions of cedis)	1,415	1,042	1,186	144	✓
Net domestic assets of Bank of Ghana (ceiling; millions of cedis)	3,095	5,755	4,794	(961)	✓
Net change in stock of arrears (ceiling; millions of cedis)	428	(643)	233	876	x
II. Continuous Performance Criteria					
Gross financing of BoG to the Government and SOEs (ceiling; in millions of cedis)	13,603	14,614	14,568	(46)	✓
Non-accumulation of external arrears (ceiling; millions of U.S. dollars)	n/a	0	0	0	✓
Non-accumulation of domestic arrears (ceiling; millions of cedis)	n/a	0	797	797	x
Contracting or guaranteeing of new external non-concessional debt (ceiling; millions U.S. dollars)	n/a	0	0	0	✓
III. Indicative Target					
Program central target rate of inflation (12 month percentage change)	17.0	15.4	16.8	1.4	x
Social Protection (floor, in millions of cedis)	947	388	n/a		

Source: IMF, Mid-Year Review of the Budget Statement and Economic Policy (July, 2015) and CEPA staff estimate

B. Revised Assessment

Our assessment is monitored based on periodic performance criteria, continuous performance criteria and indicative targets as at end-April 2015, end-August 2015 and end-December 2015, set out in Table 2 (see paragraph 91 of the ECF, p.g. 69). This assessment is in respect of the very First Review as at end-April 2015.

1 Quantitative Performance Criteria

There are five quantitative performance criteria namely, primary fiscal balance of the government, wage bill, net international reserves of the Bank of Ghana, net domestic assets of the Bank of Ghana and net change in the stock of arrears.

1.1 Primary Fiscal Balance of the Government

The floor for end April is for a deficit GH¢544 million as seen in the memorandum item in Text Table 1. The lower deficit on account of excess oil revenue translates into a lower primary fiscal balance floor a deficit of GH¢515 million as shown in the Ghana Quantitative Targets Table. Text Table 1 also shows a provisional outturn of a primary fiscal balance surplus of GH¢46 million for the review period. This provisional outcome, however, is illusory. As will be explained below this is explained by the ineffective management of payment arrears. Corrected for this abnormally, CEPA estimates a deficit of GH¢830 million. Therefore the floor was not observed by a margin of GH₵315 million.

Text Table 1: Financing

	Cumulative Jan-April 2015		
	Program	Prov. Outturn	Outturn-Program
FINANCING	**3,546**	**2,720**	**(826)**
Foreign (net)	631	970	339
Borrowing	1,119	1,646	527
Project Loan Disbursement	1,119	1,646	527
Programme Loans	-	-	-
Sovereign Bonds	-	-	-
Amortization	(488)	(675)	(187)
Domestic (net)	2,738	1,617	(1,121)
Banking	1,080	523	(557)
Bank of Ghana	420	(363)	(783)
Commercial Banks	659	886	227
Non-Bank	1,658	1,094	(564)
Other Financing	(29)	(74)	(45)
Ghana Petroleum Funds	206	206	-
Memorandum Items			
OBB (financing basis)	(3,545)	(2,720)	825
Interest Payment	(3,002)	(2,766)	236
Primary Balance (- = deficit)	(544)	46	590

Source: Mid-Year Review of the Budget Statement and Economic Policy (July, 2015) and CEPA staff estimates

Ghana has been facing financing difficulties in mobilizing domestic and external resources – a possible reason for arrears accumulation. Available data in the Mid-Year review also suggests there was a significant short fall in mobilizing financing, a short fall of GH¢826 million. Faced with these difficulties, the government decided to focus on a cost minimisation strategy without taking into consideration the full set of risk – the concern of not having to lock in high yields in the long term. By this non-resident were been cut off from the domestic market since they were not until recently allowed to participate in the short end of the market. Their exclusion may have led to the phenomenon of under subscription and the 'take all' you can situation where the total amount of bids tendered is lower than target, contributing to the shallow nature of the domestic bond market.

1.2 Wage Bill

The ceiling for the Review Period is GH¢3,413 million. The provisional outturn in the Mid-Year Review is GH¢3,341 million. On the face of it the criterion has been observed with a ‘saving’ of GH¢72 million. A closer examination of the available information (see Appendix Figure 1) suggests that the implementation of the agreement with the labour unions has been delayed and, as a result, the saving is more likely delayed payment or arrears accumulation in the Review period.

1.3 Net International Reserves of the Bank of Ghana

In the earlier assessment CEPA noted a provisional outcome of US$1,186 million compared to US$1,042 million. This means that the floor was observed and CEPA retains that assessment.

1.4 Net Domestic Assets of the Bank of Ghana

The provisional outturn of GH¢4,794 million is GH¢961 million below the ceiling of GH¢5,755 million. CEPA again retains the earlier assessment.

1.5 The Net Change in Stock of Arrears

The stock of budgetary arrears at end 2014 was estimated at GH¢6.24 billion, the equivalent of 5.5 per cent of GDP. As noted above further arrears were discovered after approval of the Program by the Executive Board of the IMF. The Program stipulates the elimination of the total stock of the budgetary arrears by end-2017, possibly in equal annual instalments. So the discovery of more arrears means an upward adjustment in the Program targets for the arrears clearance.

The Program sets a ceiling for the Net Change in stock of arrears of a reduction of GH¢424 million. In view of the discovery of more arrears referred to above, and on the basis of the data in the Mid-Year Review, CEPA estimates an adjusted required net reduction in the stock of arrears of GH¢643 million.

Text Table 2 shows a net change in stock of an increase of GH¢233 million. As shown in the Table this was on account of a combination of a shortfall in gross arrears clearance of GH¢79 million together with an accumulation of domestic arrears. The shortfall in gross arrears clearance, in turn, was on account of none of the targeted GH¢50 million road arrears being done and a shortfall of GH¢29 million in the clearance of non-road arrears. Put together the ceiling was missed by GH¢876 million with the stock at end-April rising by GH¢233 million instead of declining by GH¢643 million.

Text Table 2: Net Change in Stock of Arrears

	2015 Prog. Jan-April	**2015 Prov. Jan-April**	**Difference Prov-Prog**
Arrears Clearance Gross	(643)	(564)	79
Road Arrears	(50)	-	50
Non-Road Arrears	(593)	(564)	29
New Arrears	-	797	797
Net Change in Stock of Arrears	(643)	233	876

Source: Source: Mid-Year Review of the Budget Statement and Economic Policy (July, 2015) and CEPA staff estimates

2 Continuous Performance Criteria

There are four items under this group. These are Gross financing of BoG to the Government and SOEs, Non-accumulation of external arrears, Non-accumulation of domestic arrears and Contracting or guaranteeing of new external non-concessional debt.

2.1 Gross Financing of BoG to the Government and SOEs

The earlier assessment by CEPA noted that the ceiling of GH¢ 14,614 million was observed with an outcome of GH¢14,568 – some GH¢46 million below the ceiling. CEPA maintains this assessment.

2.2 Non Accumulation of External Arrears

Information available to CEPA and reproduced in its earlier assessment is that this continuous performance criterion has been observed over the review period. CEPA retains its earlier finding that this has been complied with.

2.3 Non accumulation of domestic arrears

CEPA estimated accumulation of domestic arrears in the amount of GH¢797 million (see Text Table 2). These were owed to what CEPA calls the ‘usual suspects’ – Wage Bill, Social Contributions, Purchase of Goods and Services, Subsidies, Transfers to Statutory Funds and Domestic Financed Capital (see Appendix Figure 1). Consequently the zero ceiling was exceeded by this amount (GH¢797). The criterion was not observed.

The program supports *“the implementation of the “procure-to-pay” (P2P) system in all 250 public spending units. The P2P system will track capture all payments from the Consolidated Fund, enabling the government to reduce the accumulation of arrears. Under P2P commitment certification control process, no contract can be signed without the corresponding budget appropriation and certification of corresponding cash availability by the Ministry of Finance. Indicative triggers in the second and third operation will extend P2P coverage to statutory funds, Internally Generated Funds (IGFs) and donor funding by end-2017”* (see paragraph 55 of the International Development Association Program Document for a Proposed Development Policy Credit and Policy-Based Guarantee to the Republic of Ghana, June 2, 2015, p.g. 23). The P2P has reportedly been implemented but perhaps it is early days yet for it to deliver fully on its promise.

2.4 Contracting or guaranteeing of new external non-concessional debt

The program target here was for zero contracting or guaranteeing of new external non-concessional debt. The anticipation was that this would be in the third quarter of this year. The available information will say this has been complied with.

3 Indicative targets

There are two items under the indicative targets i.e. Program central target rate of inflation, and social protection.

3.1 Program central target rate of inflation

The 12-month percentage change for April 2015 was set at 15.4 per cent. The realised figure for April provided by the Ghana Statistical Service (GSS) was 16.8 per cent. The indicative target was missed.

Developments in respect of the exchange rate, administered prices in respect of utilities (electricity and water) and petroleum products (transport and haulage fares) have made the modelling of inflation difficult.

The Press Releases of the MPC of the Bank of Ghana suggest that the BoG is also faced with difficulties in modelling inflation over the medium term. As a result the horizon for reaching the medium term target range of 8±2 per cent has been shifted from the fourth quarter of 2016 to the third quarter of 2017 and back from the third quarter of 2017 to the fourth quarter of 2016 on the back of a sharp appreciation of the currency. Inflation has persistently remained high and rising making the annual target of 12 per cent unlikely to achieve.

3.2 Social protection

This comprises of some sixteen items (see Appendix Table 1). The only one of these for which firm data is available is the National Health Fund (NHF), which fell short of its programmed target on account of both lower-than-targeted VAT collection (GH¢8 million) and transfers from SSNIT to the Fund on behalf of workers (GH¢11 million) for a total shortfall of GH¢19 million. In the light of the NHIL being a VAT at a rate of two and half per cent, the underperformance need to be reconciled with the apparent over performance for VAT collection as a whole. Similarly, the lower-than-targeted transfer to the NHF by SSNIT is also difficult to reconcile with the above target collection of PAYE.

C. Conclusion

The revised assessment leads CEPA to the conclusion that the fiscal consolidation process needs to be strengthened. The perennial problems with arrears, including lack of transparency leading to discoveries of unrevealed payment arrears and delayed payments, still remain.

The ‘procure to pay’ (P2P) policy, is said to have been launched and being implemented in all 250 public spending units. The CEPA assessment suggests it is yet to be effective.

The ultimate responsibility of program monitoring and coordination rests with Ministry of Finance and Bank of Ghana. To ensure greater coordination, the two institutions are expected to consult with relevant institution such as CAGD, GRA, GSS and NDPC within the Economic Policy Coordinating Committee (EPCC) framework. Moreover the program envisages that the Ministry of Finance will provide oversight responsibility for ensuring that public spending is compliant with budget limits.

The CEPA assessments suggest that the cooperation and collaboration between the fiscal authority (MOFEP) and the monetary authority (BoG) is less than required. It also suggests that collaboration and consultation in the EPCC framework could do with some improvements. Effective implementation of macroeconomic policies is needed for the achievement of the needed macroeconomic sustainability – specifically external sustainability entailing a build-up of international reserves to at least four months of import cover and controlling inflation to medium term target of 8±2. A-go-it alone by the BoG (fiscal intransigence) is likely to result in the build-up of the requisite international reserve target but with an abandonment of the inflation target. This will manifest itself in continued real depreciation of the exchange rate and high inflation. Current developments suggest that this may very well be what is happening.

Appendix

Table 1: Overview of Social Protection programs:

1. National Health Fund (NHF)	9. Capitation grant for Public Basic Schools across the country
2. Provide free school uniforms	10. Printing and Distribution of Exercise Books to Basic School Pupils under the Social Intervention Program
3. Livelihood Empowerment Against Poverty (LEAP)	11. Provide 10million free exercise books to Public Basic Schools across the country
4. Provide Government's subsidy for Senior High Schools	12. Implement First Phase of Maths and Science Reforms for 13000 KGS, 14000 Primary School and 8000 JHS
5. Fertilizer Subsidy	13. Provide core textbooks
6. Implement progressively free Senior High School Program	14. Capitation Grant
7. Basic Education Certificate Examination	15. Establishment supplies for all Public Basic Schools across the country
8. Provide feeding grant for special schools for the handicapped	16. Feeding fee for levels 100 & 200 students of colleges of education across the country

Source: IMF, Mid-Year Review of the Budget Statement and Economic Policy (July, 2015) and CEPA staff estimate

Table 2: Oil Revenue

	Jan-Apr (prog)	Jan-Apr (prov)	Δ(Prov-Prog)
Oil Revenue	516	575	59
Company Taxes on Oil	0	0	0
Royalties from Oil	144	160	16
CPI	372	415	43

Source: Source: Mid-Year Review of the Budget Statement and Economic Policy (July, 2015) and CEPA staff estimates

Figure 1: 'Usual suspects' for domestic arrears accumulation (Jan-Apr 2015)