PERSPECTIVE

The Fading Star?

Ghana's Plea to the International Monetary Fund for Help

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- The recent economic troubles of Ghana – the so-called »shining star of Africa« – show that relative stability and democratic credentials are not enough for economic development and fiscal prosperity. The source of the crisis is not only macroeconomic vulnerabilities, but also deep structural issues. The Ghanaian economy is extremely vulnerable to the electoral cycle, which was shown during the 2012 public spending overrun.

- Corruption and mismanagement are persistent, threatening both the expenditure and the revenue side of public finances. Moreover, the lack of structural transformation of the Ghanaian economy, which depends heavily on exports of primary commodities and imports of manufactured goods, creates a persistent trade deficit and makes it vulnerable to macroeconomic fluctuations.

- IMF recommendations – which can be expected to form part of the 2015 assistance conditionalities – do not seem to address these structural issues, which seem to worsen every year; and neither does the government's home-grown recovery plan. Both seem to focus on addressing macroeconomic vulnerabilities and not what causes them. Without this focus the »shining star of Africa« may soon fade away.

- The structural changes needed to ensure long-term, sustainable development are unlikely to be implemented as they require that decision-makers disturb the status quo, from which they often benefit personally. Without these changes, however – particularly in the area of good governance – the IMF and other donors can inject money into the current system without any guarantee that it will contribute to the long-term development of the country.

Ghana has long been considered the »shining star of Africa«. Since the end of military rule and the transition to democracy in 1992, the country has experienced relatively fast economic growth, with GDP per capita rising from 415 US-Dollar in 1992 to 1,850 US-Dollar in 2013 (current US-Dollar, World Bank 2014). Improvements in the business climate, particularly in the early 2000s, led to large increases in foreign investment, which is especially visible in urban areas such as Greater Accra. Moreover, according to the International Monetary Fund (IMF 2014), Ghana has outperformed other countries in the region in reducing poverty and improving social indicators. The country has recently been upgraded to the »lower-middle income« category by the World Bank. Hopes and expectations rose even further when in 2007 oil was discovered in commercial quantities off Ghana's western coast.

However, the past couple of years have shown that stability and democratic credentials are not enough for social and economic development. The outlook for Ghana's economy has become less optimistic. The country's budget deficit exploded to approximately 12 per cent in 2012 as a result of a public spending overrun and lower revenues. Overspending has been a characteristic not only of the current government, but also previous ones. The situation was further worsened by the declining prices of Ghana's main exports, cocoa, oil, and gold. The latter two recently hit four-year lows (The Economist 2014).

On one hand, Ghana is greatly dependent on the export of commodities, which makes it particularly vulnerable to changes in world market prices. On the other hand, the formal sector and productivity have been declining since the internationally-imposed Structural Adjustment Programmes of the late 1980s. Consequently, Ghana is facing a trade deficit of around 12 per cent of GDP because the value of imported goods far outweighs feeble export earnings. Imports are needed to compensate for the low productivity and the few value added products. The combination of budget and trade deficit – the so-called »twin deficits« – has led to high inflation, which reached 16.9 per cent in October 2014, and the depreciation of the Ghanaian cedi. The cedi fell by approximately 40 per cent in a year, and therefore was one of the world's worst performing currencies in 2014. As a result, economic growth slowed and the 2015 forecast was recently revised to 3.9 per cent, the lowest in two decades (IMF 2014).

Ghana was almost declared bankrupt in 2014 due to its inability to pay bills and public sector workers' wages. The financial and economic crisis not only resulted from lower state revenues, but also from the increasing corruption, mismanagement of public funds and immense overspending. The Ghanaian government, despite a long insistence on »home-grown« solutions to the crisis, reached out to the International Monetary Fund for help. Both parties have been negotiating the form of the assistance and a recovery programme since September 2014. Details of the negotiations have been kept secret due to their market-sensitive nature, but according to Ghanaian officials, the IMF will provide between 800 million US-Dollar and one billion US-Dollar in 2015 to address short-term vulnerabilities (FT 2014). Based on previous recommendations from IMF consultations on Ghana, the IMF will probably expect »fiscal consolidation« and tackling inflation in return. This will entail reducing the public sector wage bill – which is currently 70 per cent of the state budget – tax reform, less public borrowing and investment in infrastructure and development projects.

However, whether these conditions attached to potential IMF assistance will address the fundamental sources of the Ghanaian economy's vulnerabilities remains unclear. Public spending in Ghana is highly susceptible to the electoral cycle. Corruption and mismanagement are widespread, threatening the effectiveness of any recovery programme. This article will look at the current economic situation of Ghana in detail, while also tackling political aspects that make it questionable whether the government will adhere to any of the IMF's conditionalities. It will also argue that the recommendations of the Fund do not seem to address the deeper structural causes of Ghana's crisis; this failure also prevents the structural transformation of the economy and the political system.

The Renewed Plea to the IMF: An Indicator of a Desolate Political System

After Ghana made its transition from military to democratic rule in 1992, the country embarked on a widely-applauded trajectory of economic development. The relative stability of the country and the strong democratic credentials have in the past led to a favourable climate for investment and growth. Average annual growth of GDP per capita has been above five per cent in the past decade (World Bank Development Indicators 2014). Income per capita has risen more than fourfold in the past two decades, from 415 US-Dollar in 1992 to 1,850 US-Dollar in 2013 (in current US-Dollar, World Bank 2014). As a result of the high increase in income per capita the country was upgraded to »lower middle-income« by the World Bank. The value of exports of gold and cocoa – the two main exports until the discovery of oil – grew steadily. The banking and telecommunications sectors has also expanded rapidly. But high annual GDP growth and increasing GDP per capita do not provide information on the distribution of the newly created wealth among all citizens or the effective management of resources for sustainable development.

Apart from economic growth, the country experienced improvements in some social indicators. According to the Ghana Statistical Service (2014), the poverty level declined from 51 per cent in 1991 to 24.2 per cent in 2014 (measured as a count of people living on under 3.60 Ghana Cedi a day). This means that Ghana achieved its Millennium Development Goal in that area even before the 2015 target. However, 8.4 per cent of the population still live in extreme poverty. Moreover, with rapid inflation it is questionable whether it is possible to survive on 3.60 Ghana Cedi (0.93 euros) per day, or even the recently raised minimum wage of 5.38 Ghana Cedi (1.40 euros) per day. It is also questionable whether the statistics reflect the reality on the ground. The perceived situation at the moment, indeed, is a regression in the fight against poverty. Taken at face value, Ghana is also making substantial progress on other social indicators, such as literacy rates and maternal and infant mortality (World Bank 2014).

However, looked at in more depth, the improvements in literacy rates, for example, are arguable. Although enrolment rates have definitely increased substantially in recent decades, the quality of teaching is not sufficient to improve Ghana's human capital. Basic education is supposed to be free, but the majority of children leave school after the sixth grade. Most parents cannot afford to send their children to junior high school. In 2011, 53 per cent of children did not pass the basic education exams. Leaving school at around the age of 12 tends to mean that, without regular practice in reading, writing and calculating, by the age of 20 adults have forgotten most of the skills learned in school. Experts call this »functional illiteracy« (Baydar et al. 1993). The rate of functional illiteracy is estimated as being very high in Ghana.

The optimism concerning the outlook for the Ghanaian economy was strengthened by the discovery of oil in commercial quantities off the western coast in 2007. Oil production from the »Jubilee Fields« began in 2010 with major foreign investment in the exploitation infrastructure. The production is currently predicted to be around 30 million barrels per year and is expected to increase to 80 million barrels per year by 2018 (IMF 2014). Oil revenues helped make up for losses from lower gold and cocoa exports. By 2013, oil overtook cocoa to become Ghana's second biggest export after gold (IMF 2014).

The progress made in the past two decades has recently been threatened by macroeconomic instability. The Ghanaian cedi has depreciated by approximately 41 per cent against the US dollar in the past year, making imports more expensive. As Ghana imports manufacturing and consumer goods, there has been a large increase in inflation. Consumer price inflation reached 16.9 per cent in October 2014, the highest since March 2010 and well above the government's target of 9.5 per cent plus or minus two per cent (Ghana Statistical Service 2014). Producer price inflation in October 2014 was also very high, at 39.6 per cent (GSS 2014). As a result, the Bank of Ghana recently increased the base interest rate from 19 per cent to 21 per cent in order to tackle inflation. These high increases in the prices of production inputs, combined with the high cost of credit due to the high interest rate, have increased the already high costs of doing business in the country.

The main economic cause of the recent macroeconomic instability can be pinned down to the budget deficit. In 2012, the government of John Mahama had a large spending overrun, with the budget increasing to 11.8 per cent from four per cent the previous year (FT 2014). The budget deficit is financed largely through domestic borrowing, which contributes to the higher cost of credit faced by the private sector in the process known as »crowding out«. The large budget deficit has arisen from a number of factors.

The public sector wage bill increased drastically in 2012. The public sector provides 641,633 jobs in a country of just 25 million, almost as many as the formal private sector (GSS 2014). Until recently, the public sector payroll was lacking proper oversight, with reports of thousands of deceased people still receiving salaries. In 2009, the government introduced the Single Spine

Salary System (SSSS) which was meant to unify wages for appropriate job positions across the public sector. The system was intended to improve the motivation of public sector workers and enhance service delivery (FT 2014). It aimed to provide transparency and to reduce fraud and favouritism in the system. In order to harmonise the wages, however, large numbers of public sector workers received large pay increases in a short space of time. The introduction of the system without a corresponding rationalisation of the number of employees in the public sector, and a lack of increase in workers' productivity, led to a large and somewhat unexpected increase in the government's wage bill. The misguided assumption that the purpose of the public sector is to serve as an endless and all-absorbing job market to provide for government supporters increased the high wage bill even further.

Government spending on public sector wages increased by 47 per cent in just one year between 2011 and 2012, and now corresponds to 70 per cent of total tax revenue. Apart from the increased wage bill government spending also rose due to the increase in interest payments necessary to service the growing public debt.

On the revenue side, the government was unable to increase its tax revenue due to the inefficient tax collection system and a narrow tax base. Only one million workers pay their income tax and only around 1.25 million people are registered with social security schemes. Moreover, almost 90 per cent of the workforce and 40 per cent of GDP are in the informal economy, in which tax collection is limited. Some toll systems are in place (at market places or for street vendors), but tax collectors – which can even be outsourced private enterprises – retain part of the tax and toll revenue or delay payments to the state. Government revenue from exports of cocoa and gold has also decreased due to the falling prices of the two commodities: the price of gold is at its lowest in four years and the price of cocoa is also lower than it was a few years ago.

All these factors have contributed to the high budget deficit, which is one of the main factors behind the recent macroeconomic instability. Another factor is the persisting trade deficit, which is now around 12 per cent of GDP (World Bank 2014). Due to the limited manufacturing capacity of the Ghanaian economy, the country exports mainly primary commodities (cocoa, gold, oil) and imports manufactured and consumer goods. Local producers are also disadvantaged due to their limited marketing capabilities and the preference of many Ghanaian consumers for foreign goods. The trade deficit has led to the reduction of foreign reserves. By January 2014, net international reserves declined to cover less than a month's worth of imports of goods and services (World Bank 2014).

In Ghana, many observers wonder how the country got into such a difficult economic situation in relatively favourable circumstances following the start of oil production (Oxfam America 2014). In order to understand the sources of the recent economic instability in Ghana, one must look at the structural characteristics of its political economy. Ghana is extremely vulnerable to the electoral cycle. Public spending, particularly current expenditure (payroll) rather than capital expenditure (investments), increases in periods prior to the election. This is also the case with tax exemptions, which are often granted arbitrarily, without economic rationale. This was the case in 2012 in the run up to the presidential election, which was won by the incumbent John Mahama, but contested for months in the courts. Whitfield and Therkildsen (2014) point to the lack of concentrated power in the Ghanaian political system as the reason why politicians need to »pay off« voters and political rivals within their parties through public spending, clientelism and corruption. This makes Ghana particularly vulnerable to the electoral cycle, as demonstrated during the 2012 election and subsequent fiscal crisis. An example of this vulnerability is the purchase of 100,000 laptops and thousands of cars to distribute among political supporters before the 2012 election.

Corruption and mismanagement are big issues in the country. Ghana is doing well on Transparency International's 2014 Index of Perceived Corruption, achieving sixty-first position globally, and fourth in mainland Sub-Saharan Africa, behind only Botswana, Namibia and Rwanda. Despite that relative success, corruption appears to be widespread and the cause of major inefficiencies, particularly in the public sphere. This is true in the case of the previously mentioned payroll system that, until recently, was subject to little oversight and people were able to bribe their way onto it. On the revenue side, corruption and mismanagement lead to inefficient tax collection, with tax collectors even being bribed into taking lower or no tax payments. Some areas of tax collection, such as the toll and tax collection in the informal economy, have been privatised, which also gives rise to mismanagement. Furthermore, mismanagement is evident in the handling of foreign and multilateral assistance. Recent reports describe cases of donors withholding aid due to mismanagement allegations (Daily Graphic 2014). As for the »winner-takes-all« mentality of the political system, patrimonial structures function without effective checks and balances.

Longing for IMF Assistance

After months of trying to solve the deteriorating economic situation with home-grown policies, in August 2014 the government of Ghana turned to the International Monetary Fund for assistance in stabilising the Ghanaian cedi and ending the economic crisis. Details of the package are still being negotiated, with expected completion in December 2014. In a recent statement the Ghanaian Minister of Finance, Seth Terkper – himself a former employee of the IMF – stated that the country will seek a three-year soft-loan package with the IMF worth between 800 million US-Dollar and one billion US-Dollar, which will be added to the 419 million US-Dollar in outstanding debt with the Fund. The support programme could be concluded in early 2015 (FT 2014).

Although no details of the potential IMF programme have been revealed to date due to their market sensitive nature, it is not difficult to predict that the support will come with conditionalities. The IMF, in its most recent economic reviews of Ghana (the so-called Article IV consultations), recommended a number of measures for Ghana to take in order to address the economic situation. In terms of fiscal policy, these recommendations focus on three areas: revenue mobilisation, wage bill control and prioritised capital spending.

In the area of revenue mobilisation, the Fund proposes an immediate freeze on new tax exemptions, streamlining tax exemptions previously given and limiting the future power of a government to grant them. It also recommends potential increases in taxes (VAT, fuel, real estate) and a review of the tax regime for free zones and mining companies. Tax administration must be strengthened, according to the IMF, with a focus on tax compliance, particularly on the part of large tax payers. The Fund also proposed adjustment of fuel and utility prices with a rise in electricity tariffs, which will most likely impact ordinary people above cost-recovery levels once gas production is utilised for electricity generation. Unfortunately, nobody can say clearly when gas production will start.

Interestingly, there is no mention of intervention in the informal sector in which so many enterprises could have the opportunity to expand and grow their businesses. Additionally, better monitored tax collection and expanding the tax base to include the informal economy could increase the income of the state. In the area of wage control, the IMF proposes multi-year wage agreements, including the streamlining of allowances. The Fund also recommended programmes to reduce the public sector workforce, while improving its efficiency with a short-term proposal that departing employees not be replaced in overstaffed public sector areas.

However, it is also important to look at the compensation packages of higher officials. Aside from high salaries, the developing state of Ghana is also providing them with accommodation allowances, per diem payments on business trips, salaries for personal cooks and housemaids and many other things.

With regard to the third focus area – prioritised capital spending – the IMF proposed the creation of the Ghana Infrastructure Fund (GIF) and a permanent earmarking of VAT revenue to the GIF. The fund recommended prioritisation of capital spending on crucial investment projects, combined with a reduction in transfers to statutory funds to a minimum. The IMF also proposed a reduction or elimination of transfers to the Ghana National Petroleum Corporation and accelerated financial management reforms.

Although these recommendations were formulated in May 2014, one can expect that they will be part of the conditionalities of the potential IMF assistance. The government has already introduced certain steps in these focus areas. The VAT rate was raised by 2.5 percentage points and its coverage was broadened. An ad valorem fuel tax was introduced and subsidies for fuel were reduced. The government has also proposed a freeze on wage increases and net hiring in most areas of the public sector. Steps have been taken to improve monitoring and control of the wage bill through the creation of a comprehensive payroll database. The creation of the Ghana Infrastructure Fund is planned to leverage private financing of key infrastructure projects.

Despite the ongoing negotiations, Mahama has already broken his promise to stop employing new people in the public sector by introducing a new Ministry for Power on 24 November 2014. The IMF needs to reconsider their conditions for an additional loan to tackle the challenges of the political system so that future financial aid will have a positive effect on development. Two questions arise regarding the potential success of Ghana's economic recovery programme. First, are the policies recommended by the IMF appropriate and sufficient? And second, in the current political and economic system, will the Ghanaian government manage to adhere to these policies?

As the previous discussion has shown, the sources of the recent macroeconomic vulnerabilities in Ghana often arise from political economic factors. The electoral cycle, clientelism, corruption and mismanagement all cause government spending to be unplanned and inefficient. The public sector is overloaded with employees who often obtained their positions regardless of the economic need for them (or through clientelism). The IMF recommendations do not focus enough on these deep structural causes of the lack of fiscal inefficiency. Even if the government did follow the IMF's recommendations, long-term vulnerabilities of the system would not be addressed. Each subsequent government would still see the need to buy votes and political support through discretionary public spending that lacks economic rationale. This also reduces the prospects of the Ghanaian government sticking to the IMF loan conditionalities, or even to its own economic recovery programme.

The question arises of whether providing substantial financial assistance without addressing the structural and political causes of the macroeconomic imbalances have arisen recently does not create »moral hazard« (Easterly 2002). Will Ghanaian governments in the future behave differently knowing that in case of crisis they can count on IMF loans and, increasingly, funding from China? It is worth noting that following Ghana's multilateral debt cancellation under the Multilateral Debt Reduction Initiative in the mid-2000s, in 2007 the country was one of the first African countries to issue sovereign bonds on the international market at rates ten times higher than those of the multilateral debt. The level of debt quickly returned to its pre-MDRI levels, ultimately calling into question the success of the initiative.

Apart from the political economy factors, Ghana's economy faces another long-term challenge, which is another source of today's problems, namely the lack of structural transformation. The country's dependence on exports of primary commodities, with their volatile prices, and on imports of consumer goods creates unfavourable terms of trade. Ghana's growing urban middle class, with increasing spending power, is a missed opportunity for the country, which lacks manufacturing capacity. In order to prevent these imbalances from being repeated in the future, Ghana must focus on transforming its economy through diversification into manufacturing goods and higher value-added agricultural products. This transformation must create growth that is sustainable and job-creating in order to raise the living standards of Ghanaians and to increase domestic demand. The IMF's recommendations do not take into account this need to pursue a structural transformation of the economy and instead appear to be advocating maintenance of the economic status quo.

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