Ghana—The Danger of Fiscal Exuberance

Ghana's economy grew 4.5% in 2002, better than the 4.2% in 2001 and the 3.7% in 2000, but well below the target of 8% as outlined in *Vision 2020*. The robust recovery in gold and cocoa prices boosted the economy. Gold rose from $325 an ounce in 2001 to $347 in 2002. Cocoa prices soared to a 16-year high of $2,157 a ton in September 2002, 60% higher than in September 2001, given the disruption of production with the military uprising in Côte d'Ivoire, the world's largest cocoa producer.

> *The robust recovery in gold and cocoa prices boosted the economy*

External reserves improved to about three months of imports in 2002, while the cedi remained stable against most major currencies. But the current account deficit increased from 4% of GDP in 2001 to 6.2% in 2002, largely because of high oil prices and high debt servicing costs. Lower debt service payments under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative should improve the external balance, to the tune of about $273 million.

The monetary policy stance improved in 2002—with inflation down to 15%, from 21% in 2001 and 40% in 2000. The inflation outturn was due largely to a substantial improvement in food supply, prudent monetary policy, and fiscal restraint. Interest rates kept to their downward trend, with the benchmark treasury bill discount rate declining from 27% at the end of December 2001 to 25% in September 2002. The fiscal deficit declined to 6% of GDP in 2002 from 9% a year before. A major setback for the stability of the financial sector: the accumulating debt of Tema Oil Refinery, more than $400 million in December 2002, a result of government delays in allowing total cost recovery for petroleum products distributed in the country. To restructure the refinery's debt, subsidies on petroleum had to be lifted—this led to a 93% increase in petroleum prices in January 2003.

Rapid growth in the money supply and high inflation have hurt economic performance in recent years, locking Ghana into a low quality growth equilibrium by dampening private investment—a key determinant of economic growth.

- First, huge budget deficits and associated spikes in inflation heightened uncertainty about the government policies. This increased the risk premium in Ghana, leading domestic and foreign investors to wait and see.
- Second, the huge fiscal deficits led to an explosion in domestic debt, which crowded out credit to the private sector, further constraining financing options for firms.
- Third, deficit financing through the issue of high-yielding treasury bills has inverted the yield curve on government securities, giving higher rewards to

investors in short-dated securities than in long. So, many potential investors prefer to hold short-term instruments, restricting private firms from raising long-term capital. This means of deficit financing has also shifted resources from the securities market to the government bill market, leaving the securities market thin and illiquid.

For 1995–2002 private investment averaged only 4.1 percent of GDP, despite the recent improvements in fiscal discipline.

National poverty statistics show a decline from 52% to 40% over the past decade—lifting 2 million people out of poverty

National poverty statistics show a decline from 52% to 40% over the past decade—lifting 2 million people out of poverty. But the national statistics mask wide regional disparities, with increases in 3 of 10 regions—central, northern, and upper east. The trend in other social indicators is promising, with life expectancy up from 49 years to 57 and youth literacy reaching 91% in 2001. Of concern, per capita government spending on health and education has declined.[1]

The medium-term outlook is cautiously optimistic largely because of better fiscal discipline and stronger exports. Rising external inflows from cocoa proceeds, gold sales, and remittances will stabilize the exchange rate. But downside risks include the danger of lax monetary and fiscal policies in the runup to the general election in 2005, especially massive wage increases unsupported by productivity gains. The conflict in Côte d'Ivoire could increase the risk premium for foreign and domestic investment, dampening private sector activity and depressing remittances from the thousands of Ghanaians in Côte d'Ivoire. Additional downside risks include the high levels of domestic debt that may crowd out private investment and derail social programmes. Overall, however, Ghana stands to benefit as a result of the Côte d'Ivoire crisis.

A key policy challenge is to jump-start public service reforms in financial and economic management. Vigorous pursuit of these reforms will help promote a stable fiscal environment for private sector development and enhance implementation capacity for the country's poverty reduction and social programmes. Other key challenges are to reverse the worsening of rural poverty and ease the political tensions arising from the debt-driven petroleum price increases in January 2003.

Recent economic developments

Despite better macroeconomic management, economic growth rose only slightly (box 5.1 and table 5.1). The 4.5% growth in 2002 is consistent with the average growth rate over the past 15 years, leading observers to suggest that Ghana is locked into a low growth trap (figure 5.1). Perhaps of more concern, growth has not transformed the structure of the economy or delivered significant improvements in the quality of life (Aryeetey and Fosu 2002; Killick 2000; Aryeetey, Harrigan and Nissanke 2000).

The structure of the economy shifted in the 1990s towards services, with little change in the share of industry. This shift is not a sign of structural change but merely reflects the direction of new short-term capital flows marking the end of stagnation (Aryeetey and Fosu 2002). Much of the increase in the share of the services comes from low-tech activities—wholesale, retail, restaurants, and hotels.

Underinvestment is the most consistent explanatory variable for the growth differences between Ghana and other countries (figure 5.2) (O'Connell and Ndulu 2000; Asea and Paddison 2003). This confirms other studies that show investment to be the most robust explanatory variable in the growth equation of developing countries (Levine and Renelt 1992). For Ghana, fiscal exuberance, reflected in high inflation and high government spending, has depressed economic growth.

Box 5.1

Better economic management in 2001—the new government's first year

The government has managed the economy and met all the monetary and fiscal performance indicators under the International Monetary Fund (IMF)/World Bank programmes for 2001:

- The overrun on public sector borrowing requirements dropped from 981% in 2000 to a moderate 27% in 2001, while net domestic financing, adjusted for domestic payment arrears, improved from 9.3% of GDP in 2000 to 2.3% in 2001.
- The average inflation rate fell from 41% at the beginning of 2001 to 21% at the end of 2002.
- The average rate of depreciation of the cedi against the dollar declined from 49% in 2000 to 3.7% in 2001.
- The treasury bill rate declined from 47% to about 29%.
- Tax revenue increased by 18% through more effective tax administration.
- The net foreign assets position improved from –300 billion cedis (about $45 million) in 2000 to 2,300 billion cedis (about $180 million) at the end of 2001.
- Import cover of external reserves improved from 1 month in 2000 to 1.7 months in 2001.
- Streamlining the public debt accounting framework and shifting government domestic borrowing from bank to nonbank instruments eased pressure on credit available to the private sector.

Source: *Economic Commission for Africa, from official sources.*

Table 5.1

Sectoral growth rates, 1998–2002 (%)

Sector	1998	1999	2000	2001	2002[a]
Agriculture	5.1	3.9	2.1	4.0	4.1
Industry	3.2	4.9	3.8	2.9	4.7
Services	6.0	5.0	5.4	5.1	4.7
GDP	4.7	4.4	3.7	4.2	4.5

a. Estimated.

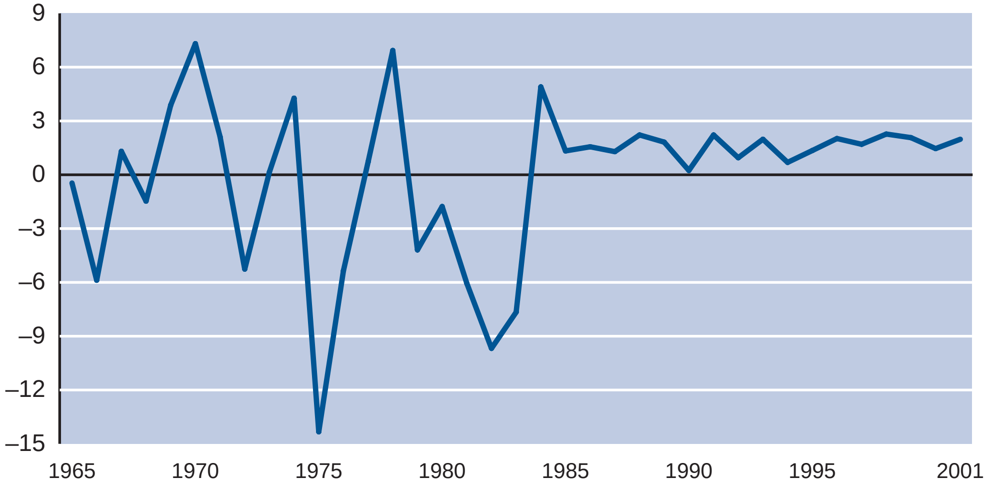
Source: *Economic Commission for Africa, from official sources.*

Mining, up by about 5% in 2002 after a decline of 2% in 2001, and an upsurge in construction accounted for much of the growth in 2002. The weaknesses in mining, caused by a slump in the world price of gold in 2000 and early 2001, was overcome in 2002, as production increased. Ashanti's gold production, down from 914,699 ounces in 2000

Figure 5.1

Low quality growth trap?

Real GDP per capita growth, 1965–2001 (%)

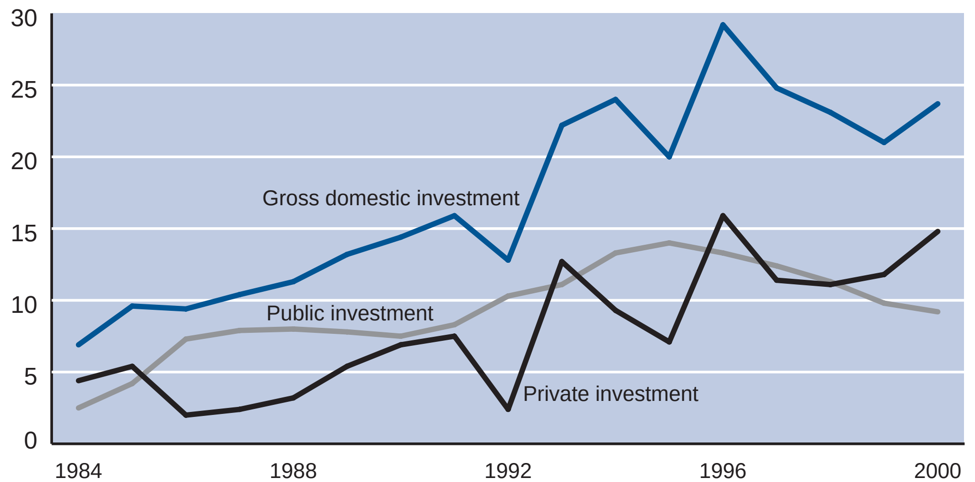


Source: *Economic Commission for Africa, from official sources.*

Figure 5.2

Investment—disappointing

Gross domestic investment, public investment, and private investment, 1984–2000 (% of GDP)



Source: *Economic Commission for Africa, from official sources.*

to 781,503 ounces in 2001, will probably exceed 800,000 ounces in 2002 (Ashanti Goldfields Ltd. 2002).

Agriculture contributed about 36% of GDP in 2002, industry (including mining) 25%, and services 39%. The distribution of GDP has remained much the same since 1997, with the share of the services increasing marginally from 38% in 1997 to 39% in 2002 at the expense of agriculture, whose share fell from 37% to 36% (figure 5.3).

> *With good weather, food crops exceeded their targets in 2002, pushing down the prices of some staple foods by more than 75%*

Agriculture—exceeds targets

With good weather, food crops exceeded their targets in 2002, pushing down the prices of some staple foods by more than 75% from December 2001 to December 2002.

Maize production in 2002 was 1.6 million tons, compared with the target of 1.4 million tons (Ghana, Ministry of Food and Agriculture 2003). Cassava recorded a surplus of 3.9 million tons, about 40% greater than the target of 9.8 million tons. Yam and plantain had surpluses of 2.2 million and 2.8 million tons. Rice production—which in the 1970s and 1980s accounted for 60% of national consumption and helped reduce the pervasive poverty in the northern regions, where rice is grown—picked up in 2001 with 316,000 metric tons from 230,000 tons in 2000.

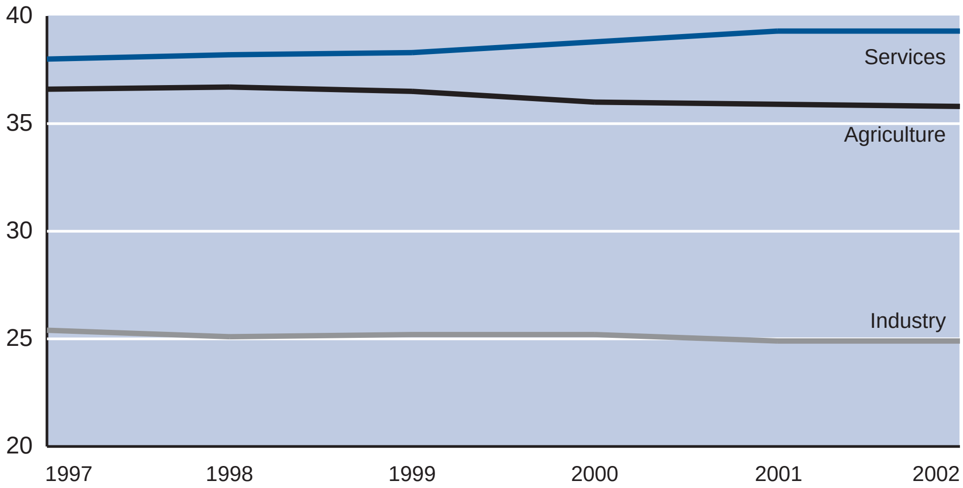
For food crops, the livelihood for more than 60% of Ghanaian households, the government is concentrating on storage, processing, mechanization, and small-scale irrigation.

The President's Special Initiatives for accelerating growth and poverty reduction include specific actions for cassava. A sizable amount of the surplus production is to be

Figure 5.3

No structural transformation

Sectoral distribution of GDP, 1997–2002 (%)



Source: *Economic Commission for Africa, from official sources.*

converted into products such as *gari*, cassava dough, and cassava powder, common staples for about 100 million indigenous people in coastal west and central Africa. The Ministry of Women and Children's Affairs, through its Women's Development Fund, acquired and installed 200 gari processing machines in the cassava growing areas of the country. A $4 million starch plant started operating in March 2003. And high-yielding disease-free cassava sticks have been introduced for planting. These initiatives will improve incomes for food farmers, the poorest occupational group in the country.

"Energy supply has been one of the most formidable constraints to industrial production"

Cocoa remains one of the most important tree crops, providing livelihoods for more than a million Ghanaians and accounting for a third of foreign exchange. Of concern is the smuggling of cocoa to Togo and Côte d'Ivoire, one source of the long-term decline in formal production since the 1970s, because of the wide differences in producer prices between Ghana and its neighbours.

With the military uprising in Côte d'Ivoire, cocoa prices soared to $2,157 a ton in September 2002, about 60% higher than in December 2001. But this rise did not immediately help foreign exchange earnings because most cocoa is sold in forward markets.

Recent measures by government to improve cocoa production include introducing new agronomic technology, increasing producer prices, rehabilitating feeder roads in cocoa-growing areas, conducting regular spraying exercises to control diseases and pests, boosting local processing, and educating farmers. The Cocoa Research Institute of Ghana, in collaboration with the Ghana Cocoa Board, is experimenting with a new hybrid technology that will make cocoa an all-year crop in Ghana, to be harvested nine times instead of the present three.

Industrial performance—disappointing

The contribution of the manufacturing sector dropped from 15% of GDP in the mid-1970s to 9% in 2001. Ghana's industry was heavily protected under import-substitution policies after independence, and with the liberalization of trade in 1984 many firms lost their monopoly positions and collapsed, especially in textiles and garments.

Energy supply has been one of the most formidable constraints to industrial production, with rising oil prices and power rationing because of low water levels at Akosombo Dam. The Volta River Authority has an installed capacity of 1,652 megawatts (MW), but produces only around 750 MW because of failed rains. National demand is 1,210 MW. The deficit is met by imports of electricity from Côte d'Ivoire, while consumption growth is held in check through load shedding and other power sharing arrangements (figure 5.4). To improve the situation, Ghana has begun constructing thermal power plants, and the Takoradi thermal plant produces 385 MW.

Ghana is also a partner in the West Africa Gas Pipeline Project, a 600-kilometre natural gas transmission pipeline from Nigeria through the Republic of Benin to Ghana, at an estimated cost of $500 million. The pipeline, which will have lateral lines to supply

Benin and Togo, will transport gas from the vast reserves in Nigeria. About 85% of the gas transported to Ghana is for electricity generation and the remaining 15% for industrial development. The government considers the project a cornerstone of the National Energy Security and Sustainability Strategy. Gas deliveries from the project are expected to start in late 2005 or early 2006.

Services—slowing down

Services, previously showing the strongest growth, slowed from 5.1% in 2001 to an estimated 4.7% in 2002, due to a slowdown in the expansion of government services. Tourism remained the fastest growing service, with hotels and restaurants expanding rapidly, pushing receipts from $205 million in 1993 to $386 million in 2000. Tourist arrivals, mostly Ghanaians living abroad, rose from 257,000 to 399,000 in the same period, implying an increase in the average expenditure per tourist from about $800 to $970.

> *"Tourism remained the fastest growing service, with hotels and restaurants expanding rapidly"*

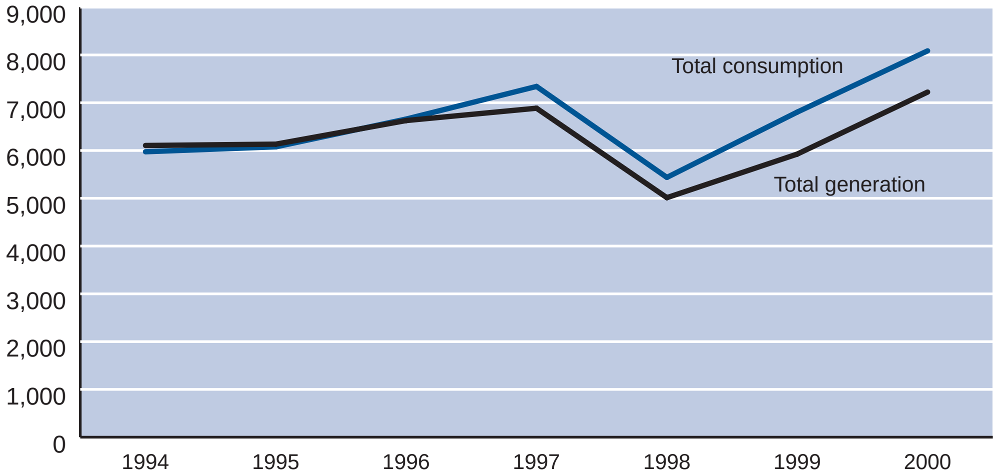
Growth in telecommunications has been slower than expected, due largely to problems in the privatization of Ghana Telecom and in the licensing contracts of some new companies. To take over the direct management of Ghana Telecom, the government of Ghana brought in Telekom Malaysia, which holds only 30% of the shares.

Another problem is noncompliance with contractual agreements. Western Telecommunications (WESTEL), one of the four cellular phone operators in the country, agreed to provide 400,000 connections between 1996 and 2000, but by the end of 2001 had reportedly provided only 2,000 connections. So growth in telephone lines has been sluggish.[2] Telephone mainlines increased from 3 per 1,000 people in 1990 to 12 in

Figure 5.4

Electricity production—short of demand

Electricity supply deficit, 1994–2000 (millions of kilowatt-hours)



Source: *Economic Commission for Africa, from official sources.*

2000, while cellular phone subscribers increased to 6 per 1,000 people from almost zero—both well below the average for Sub-Saharan Africa of 15 mainlines and 19 cellular subscribers per 1,000 people.

Monetary policy stance—improving

Inflation declined from 21% in 2001 to 15% in 2002, thanks to the improved food supply and the stability of the cedi

The year-on-year growth in broad money (M2+) increased almost 48% in 2002, up from 36% in 2001. All the major components of broad money, particularly savings, time deposits, and foreign currency deposits, reflected the increase (table 5.2). Even so, the Bank of Ghana and the government remain committed to restraint. Interest rates maintained their downward trend, though at 32–40% the rates are still too high to make bank credit accessible to the private sector. The treasury bill discount rate fell to 24% in September 2002, from 27% in December 2001, while the major commercial banks adjusted their base interest rates down from an average of 35% in December 2001 to 27% in April 2002. The average bank lending rate remained high at 36%, way above the average interest rates on demand and savings deposits of 8–9.5%.

Inflation declined from 21% in 2001 to 15% in 2002 (figure 5.5), thanks to the improved food supply and the stability of the cedi against the dollar, supported in part by the inflow of remittances from Ghanaians abroad, $1.2 billion in 2002. Food prices, with a 52% weight in the Consumer Price Index, fell in the last quarter. But monetary growth threatened price stability because of the growth in foreign currency deposits and quasi money. Inflation is certain to rise in 2003 (the projection is 18%) with the 98% petroleum price increase announced in January 2003.

Other important policy actions in 2002 include the Bank of Ghana Act, establishing the independence of the central bank. It also establishes a Monetary Policy Committee,

Table 5.2

Money supply and its makeup, 1999–2002 (billions of cedis)

Money supply	1999	2000	2001	2002[a]
Narrow money	2,543	3,534	5,155	6,979
Quasi money	1,434	1,788	2,752	4,207
Broad money supply, M2	3,977	5,323	7,907	11,179
Foreign currency deposits	970	1,943	2,374	3,990
Broad money supply, M2+	4,947	7,266	10,281	15,169
Net foreign assets	57	-299	1,503	2,303
Net domestic assets	4,891	7,564	8,778	12,866
Net credit to government sector	3,024	6,068	6,563	8,604
Net credit to private sector	2,466	3,836	4,472	10,009
Other items	-600	-2,340	-2257	-5,747
Total money supply	4,947	7,266	10,281	15,169

a. Projections based on end-September figures.

Source: *Economic Commission for Africa, from official sources.*

to help the Bank of Ghana design appropriate policies to maintain macroeconomic stability and mobilize savings for national development.[3] The bank revised its reserve requirement on foreign currency holdings to encourage foreign currency deposits, allowing commercial banks to hold primary (cash) reserves against foreign currency deposits in foreign currency rather than cedis.

Monetary convergence—generally slow

Progress towards establishing the Second West African Monetary Zone by 2005—with Ghana, The Gambia, Guinea, Nigeria, Liberia, and Sierra Leone—has been slow, both in establishing the required institutions and in fulfilling the convergence criteria (box 5.2). The union is aimed at facilitating trade, travel, and tourism among West African countries. Public awareness campaigns in member countries began in February 2002 to ensure that the public fully understands the costs and benefits of monetary integration. A fast-track approach, involving external technical assistance to member governments and central banks under the new West Africa Monetary Institute in Accra, is to achieve the convergence criteria by 2005. Ghana has made good progress towards the convergence criteria, to be fully met by the end of 2004 (table 5.3).

> *"The bond market remains extremely weak, and the banking system is plagued with nonperforming loans"*

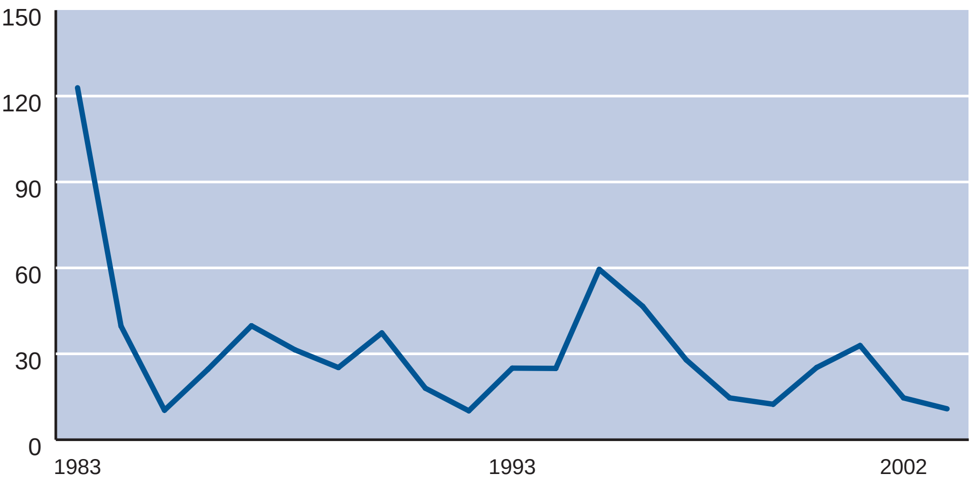
Equity and credit markets—not serving the private sector well

Equity and credit markets are an important source of finance. But the equity market is still in its infancy. The bond market remains extremely weak. And the banking system is plagued with nonperforming loans.

Figure 5.5

Inflation down again

Inflation (Consumer Price Index), 1983–2002 (%)



Source: *Economic Commission for Africa, from official sources.*

The Ghana Stock Exchange began operation in 1990, but it remains small with a market capitalization of only 1.2% of GDP, compared with 6.2% in Côte d'Ivoire and 5.2% in Kenya. Turnover remains sluggish at 0.5, compared with 2.2 in Kenya.

The Ghana Stock Exchange All-Share Index rose from 956 at the beginning of 2002 to 1,395 at year's end (figure 5.6). The government is privatizing the Cocoa Processing

Box 5.2

Will Ghana benefit from monetary union?

Ghana is one of five West African countries contemplating establishing a second West African monetary zone. A recent study finds that Ghana, The Gambia, Guinea, and Sierra Leone would be worse off in the zone than if they had their own monetary policies. Nigeria is the only country that will be better off. Ghana suffers a net loss because of three factors:

- Nigeria has very high spending propensities relative to the other countries.
- Nigeria has very different terms of trade shocks from those of the other countries.
- Nigeria accounts for 68% of the group's GDP, so it would dominate the union's monetary policy.

Ghana accounts for 18% of the group's GDP, has a spending propensity almost the same as the average for the group, and its terms of trade shocks are negatively correlated to the average for the group. But if Ghana enters a monetary union that includes all Economic Community of West Africa States, the net benefits to Ghana are positive because its spending propensity is higher than the average for the group. When Nigeria's spending propensity is the same as the average for the Economic Community, Ghana's membership gain increases because Nigeria's fiscal distortion is eliminated.

Source: *Masson and Patillo 2001.*

Table 5.3

Ghana's performance on convergence criteria, 2000–03 (%)

Indicator	New West Africa Monetary Zone target	2000	2001	2002[a]	2003[b]
Inflation rate	Single digit	40.7	21.3	15.2	18.0
Fiscal deficit/GDP	5 or less	9.7	9.0	6.0	5.0
Central bank financing/ tax revenue	10 or less	57.9	17.9	10.0	10.0
Foreign reserves (months of import cover)	3 or more	1.0	1.7	2.6	3.0

a. Estimated.

b. Targeted.

Source: *West African Monetary Institute 2001; Economic Commission for Africa, from official sources.*

Company by divesting 25% of its shareholding, which would increase the number of listed companies to 24. The company will have a capitalization of more than 800 billion cedis, second only to Ashanti Goldfields Ltd., which has a market capitalization of 2,100 billion cedis.

Credit markets in Ghana perform poorly because of the way the government finances its expenditures. Issuing large quantities of high-yielding bills to meet fiscal requirements has inverted the yield curve on government securities, giving higher rewards to investors in short-dated securities. So, many potential investors, including banks, prefer to hold short-term government treasury bills. This has shifted resources from the money markets to the government bill market, leaving the money markets both thin and illiquid. One solution to this problem is to revitalize the bond market.

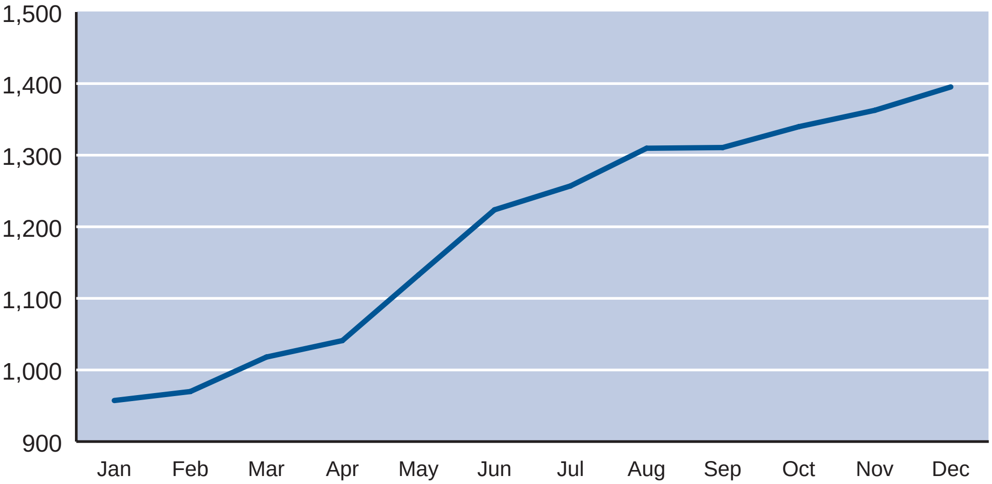
"An encouraging recent development: greater fiscal discipline"

The lack of a vibrant bond market can be attributed to the unfavourable economic environment, the availability of investment substitutes, weak secondary markets, and the absence of a credit rating agency.

Fiscal policy—greater discipline, but some slippage

An encouraging recent development: greater fiscal discipline. Note the turnaround from unbridled, wayward spending to strict management of scarce government revenues—and from careless seepage of tax proceeds into private pockets to controlled channeling of proceeds into the government treasury. The overall cash deficit declined from 8.5% of GDP in 2000 to 4.4% in 2001 (table 5.4). The outturn for 2002 deteriorated, however, with the cash deficit rising to 6.9% of GDP.

Figure 5.6
Stocks up 46%
Ghana Stock Exchange All-Share Index, 2002



Source: *Economic Commission for Africa, from official sources.*

All major components of government revenues (except nontax revenue) exceeded their targets, with taxes on international trade overperforming by over 30%, thanks to better tax administration and surveillance on the borders. Nonreceipt of project and programme grants was the main reason for the shortfall in nontax revenues, about 50% of the target. By the third quarter of 2002, only 18% of programme grants had been received. Assistance under the Heavily Indebted Poor Countries (HIPC) Initiative, about $273 million, exceeded the target.

"The biggest fiscal challenge at the beginning of 2001 was the domestic debt"

The increase in the 2002 deficit is attributable mainly to the programme expenditures arising from grade adjustments in the Ghana Education Service under the Universal Salary Structure and the payment of additional duty allowances in the public health sector—and to the delays in external inflows.

The public sector borrowing requirement, a key performance criterion for the IMF's Poverty and Growth Facility arrangement, has been consistently breached. For example, it was overrun by 981% in 2000. But the overrun in 2001 was only 27%. Financing by accumulating payments arrears declined from a high of nearly 33% of total domestic borrowing in 1999 to 2.5% in 2001.

The biggest fiscal challenge at the beginning of 2001 was the domestic debt. When the new government took over in January 2001, the domestic debt was not immediately known. Different government agencies supplied figures that changed by the day, in a range of 9 to 12.5 trillion cedis. The recent improvements in public debt accounting should address this uncertainty. And the shift from bank to nonbank instruments to meet the government's borrowing requirements means less crowding out of the private sector.

Table 5.4

Fiscal performance 2000–02 (billions of cedis)

Item	2000	2001	2002[a]
Payments	9,916	11,680	16,359
Receipts	9,916	11,680	16,359
Total tax revenue	4,811	6,904	8,786
Grants	574	1,570	1,982
Other receipts, including project loans and divestiture proceeds	2,134	2,344	4,660
Net domestic financing	2,397	862	139
Financing gap	0	0	792
Overall cash deficit (% of GDP)	8.5	4.4	6.9
Domestic revenue (% of GDP)	17.7	18.2	18.7
Tax revenue (% of total payments)	48.5	59.1	53.7

a. Estimated.

Source: *Economic Commission for Africa, from official sources.*

External trade and payments—better in 2002

The Ghanaian economy is very dependent on the external sector. Gold, cocoa, and timber contribute more than 70% to export revenues while 60% of the country's budget is supported by external inflows. So any external shock easily manifests itself first in the exchange rate, which then reverberates to other aspects of the economy. Between 1984 and 2000 the nominal exchange rate fell from 36 cedis to the dollar to 5,400. In 2000 alone the nominal exchange rate was down by 98%, but year on year there was a deceleration to 5% in 2001 (figure 5.7).

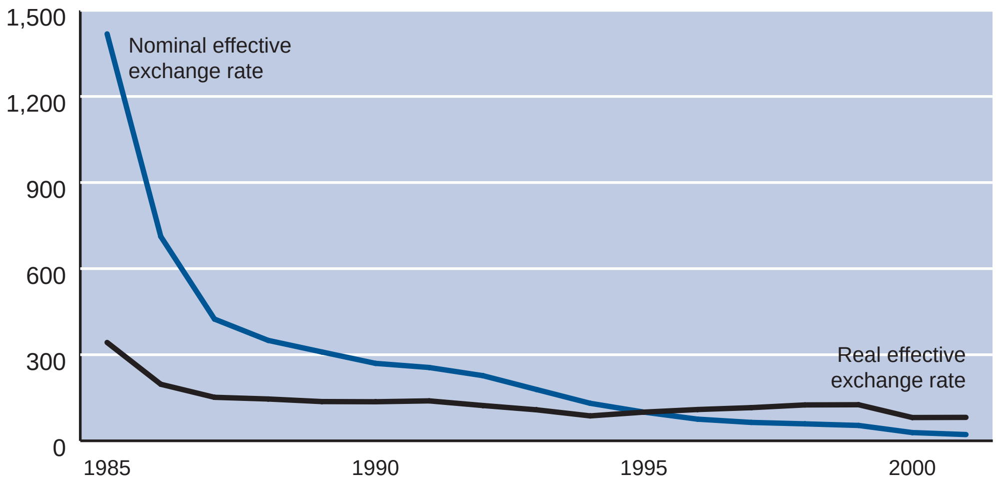
The Ghanaian economy is very dependent on the external sector—60% of the country's budget is supported by external inflows

The external balance worsened in the 1990s. In 1997 the balance of trade deficit was 5.8% of GDP, compared with 1% in 1984, and in 2000 it increased to 8.4% (table 5.5). What explains this? Weak export capacity, the long-term decline in international prices for cocoa and gold, and rapid growth in the demand for consumer imports.

Figure 5.7

Exchange rates—plummeting

Effective nominal and real exchange rates, 1985–2000 (1995=100)



Source: *Economic Commission for Africa, from official sources.*

Table 5.5

External performance, 2000–02

	2000	2001	2002[a]
Trade balance (US$ millions)	–830	–848	–821
Growth of exports (%)	–3.5	–2.2	7.6
Growth of imports (%)	–15.2	–3.9	7.8
Average cedi-dollar exchange rate	5,431	7,300	8,200
Current account balance (% of GDP)	–8.4	–6.6	–2.2
Gross external reserves (months of imports)	1.0	1.7	2.6

a. Estimated.

Source: *Economic Commission for Africa, from official sources.*

The external reserve position depends on aid inflows, given the weaknesses of exports. In 2000 the import coverage of external reserves dropped to about one month. Despite one of the worst trade performances in 2001, a substantial increase in external assistance improved the balance of payments, and gross international reserves rose slightly to seven weeks of import cover. Exceptional programme support—$364 million in programme grants, concessional loans, and deferred loan repayments—moderated the poor performance of traditional exports in the balance of payments.

Ghana reached the decision point under the enhanced HIPC Initiative in February 2002

The enhanced HIPC Initiative

Ghana was eligible for debt relief under the enhanced HIPC Initiative in 1999, but not until February 2001 did the government opt for debt relief. When Ghana became eligible for relief in 1999, its debt burden indicators were not significantly above the critical values. The relief that Ghana would have qualified for was thus not very large, especially given the costs. One such cost was Japan's warning that Ghana, under the HIPC Initiative, would not be eligible for bilateral loans from Japan.

At the end of 2000 the total nominal public external debt stock was estimated at $5.9 billion, including $40 million in repayment arrears. Total debt in net present value terms was estimated at $3.8 billion, about 558% of government revenues, 152% of exports of goods and nonfactor services, and 77% of GDP. (Table 5.6 shows the estimated impact of debt relief on debt service ratios.) Of the debt 52% was owed to multilateral creditors and 48% to bilateral and commercial creditors. The International Development Association (IDA), IMF, and African Development Bank accounted for 93% of the multilateral debt. Japan and the United Kingdom were the largest bilateral creditors, with 60% and 10% of the bilateral outstanding debt. Commercial debt amounted to $348 million in nominal terms, with Samsung of Korea the largest creditor with 37% of the outstanding commercial debt in nominal terms in 2000. Contracted by the Tema Oil Refinery, this debt is collateralized against the company's assets.

Ghana reached the decision point under the enhanced HIPC Initiative in February 2002. An estimated $2,186 million in debt relief is required to bring the net present

Table 5.6

Estimated medium-term impact of enhanced HIPC Initiative debt relief

Indicator	2001	2002	2003	2004	2005
Debt service ratio before debt relief (%)	n.a.	15.7	15.2	14.3	13.0
Debt service ratio after traditional debt relief (%)	20.3	14.5	13.0	2.4	11.3
Debt service ratio after enhanced HIPC relief (%)	8.9	5.0	4.1	3.4	3.4
Exports of goods and services (US$ billions, projected)	2.42	2.59	2.83	3.05	3.26

n.a. Reliable data not available.

***Source:** Economic Commission for Africa, from official sources.*

value of the debt to revenue ratio below the critical value of 250%. In 2002 the projected debt relief for Ghana was $273million, with 20% to be used for domestic debt reduction and the remaining 80% earmarked for poverty reduction programmes and activities. To reach its completion point, Ghana is expected to undertake certain actions and achieve specified targets (box 5.3).

Box 5.3

Ghana's HIPC Initiative relief triggers

Poverty Reduction Strategy

- Formulate and satisfactorily implement the Ghana Poverty Reduction Strategy for at least one year.
- Maintain macroeconomic stability.
- Ensure appropriate use of budgetary savings from HIPC relief.

Governance

- Establish a procurement regulatory and oversight body to implement the new governance code.
- Develop internal audit capacity through full staffing of internal audit positions.

Public expenditure management

- Publish regular reports on cash expenditures and commitments by ministries, departments, and agencies.
- Install a computer-based financial management information system on a pilot basis in the Ministry of Finance, Controller and Accountant General's Department, and at least two key sector ministries.

Social indicators

- Increase gross primary enrolment rates for girls from 72% in 2002 to 74%.
- Increase the percentage of rural households with access to safe water from 40% in 2000 to 46%.
- Increase district and subdistrict share in recurrent health expenditures from 42% in 2000 to 45%.

Decentralization

- Submit a Local Government Services Bill to Parliament.
- Develop a monitoring system to provide regular data on local government activities.
- Develop district composite budgets in pilot districts.

Energy

- Maintain an automatic pricing formula in petroleum, allowing for cross-subsidization of products.
- Move to full economic pricing in the electricity sector, with lifeline provision to allow access to electricity by low-income consumers.

Source: *Economic Commission for Africa, from official sources.*

Promoting export-led growth

Ghana can also reduce its debt service ratio and boost growth by increasing exports (boxes 5.4 and 5.5). Nontraditional exports, with a value of more than $400 million in 2001, are receiving more government support through the Export Promotion Council (figure 5.8). There has also been a strong campaign to take advantage of the U.S. African Growth and Opportunities Act (AGOA) in Ghana, with a Presidential Special Initiative on garments.

The Export Action Programme for Garments and Textiles aims to develop a critical mass of high growth-oriented, internationally competitive exporting firms targeting U.S. and European markets. It supports training schemes for companies to improve

Box 5.4

The false seduction of protection

Ghana has tried to use import tariffs to protect local producers, a response to some policymakers who believe that they should have more flexibility to respond to emerging "needs" for protection. The garment and textile industry illustrates some of the difficulties.

Garments, a basic good for all Ghanaians, are subject to an import tariff of 25%, intended to assist local producers. But the magnitude of the tariff, together with the size of the local market, serves as a magnet to smugglers. Two of the most important forms of smuggling are transit shipments and imports of "used" clothing.

Assume that 10 containers enter Ghana for transshipment to a neighboring country. As transit shipments they are exempt from import duty. The goods are accompanied by customs officials while in transit to the neighboring country and are documented as being cleared out of Ghana. In reality, through collusion by dishonest traders and customs officials, only one of the containers (at most) actually leaves Ghana, with the contents of the remainder sold in the local market. This is good for local consumers, for the traders, and for the customs officials involved. But it severely reduces government revenue and the protection provided to local garment producers by the 25% tariff.

Without smuggling the 25% tariff on garments would raise domestic prices 25% above world prices. If the tariff also raised the price of cloth, the main input, by 25%, the garment industry would benefit from substantial effective protection of about 25%. However, with widespread smuggling and undervalued imports of used clothing, the tariff is unlikely to raise the prices of garments by much more than 10%. This would make the effective protection for garments negative, probably –35%. Heavy protection of textiles is harmful to garment producers. So, despite earnest efforts to protect all segments of the garment and textile industry, the government has been more successful in subsidizing smuggling and negatively effecting protection to garments, the most labor-intensive sector of the industry—certainly not the government's intention.

A much simpler and more uniform tariff structure, starting with a maximum rate of no more than 10%, would provide more neutral protection, reduce smuggling, contribute to government revenues, and likely reduce the local price of clothing.

Source: *Economic Commission for Africa, from official sources.*

quality and provides financial assistance and other support. Small industrial villages have been established to make garments for export to the United States. Fourteen garment and textile companies benefited from training schemes to improve their standards in 2002. Nontraditional exports to the United States increased from $35 million in 2001 to an estimated $42 million in 2002. The initiative is expected to inject $3 billion into the economy and create 90,000 full-time jobs for Ghanaians.

Box 5.5
The dangers of using tariffs for income redistribution

It is tempting to try to use import tariffs to achieve redistribution goals, taxing imports of luxury goods at relatively high rates and exempting or zero-rating imports of basic goods. Ghana does this to some extent already. Bicycles, a basic good, face a zero rate of import duty; television sets are taxed at 10%, video-cassette recorders at 25%. (But footwear and garments are taxed at 25%, a high rate for such basic goods.)

Using import tariffs for this purpose ignores two important side effects of protection:

- Tariffs distort investment decisions, thus diminishing the efficiency with which a country uses its capital resources and reducing the long-run rate of development.
- Tariffs affect the demand for labor and other primary inputs, thus influencing the distribution of income at its source.

Placing high tariffs on luxury goods, for which demand is relatively small in a poor country like Ghana, provides an artificial incentive to invest in industries producing such goods. But providing low or negative protection to basic goods, such as bicycles, prevents the development of labor-intensive industries whose products are in high demand.

Facing a zero rate of import duty, bicycles are also zero rated for VAT purposes, which means that local bicycle producers would not be able to get any tax credit on their inputs, putting them at a disadvantage relative to imports of VAT-exempt bicycles. As might be expected in these circumstances, no domestically produced or assembled bicycles are available in the market. The Tariff Book has recently been amended to add an item to chapter 98 zero rating (for import duty purposes) parts and components used in the production or assembly of bicycles. At best this will make the tariff system neutral for bicycle production.

Meanwhile, high tariffs on luxury goods encourage smuggling or (worse) the establishment of inefficient industries assembling goods with little demand in the local market.

Penalizing low-skill, labor-intensive industries and subsidizing higher tech, more capital-intensive industries reduce demand for the poorest workers in Ghana and impede development of industries in which Ghana might have a strong comparative advantage. This does not serve the redistribution purpose for which such measures were designed. And it reduces Ghana's long-term development potential.

The answer is not, of course, to give high protection to basic goods either. Difficulties with this approach can be seen in the garment industry. The lesson is that the tariff regime should be as neutral as possible—through low and uniform rates.

Source: *Economic Commission for Africa, from official sources.*

The Integrated Action Programme for Cassava Starch Production and Export is aimed at job creation and poverty reduction in rural communities. A Presidential Special Initiative on cassava promotes the production and export of cassava starch. A $4 million starch processing plant, the second of its kind in Africa, has been commissioned at Bawjiase in the central region to process about 20,000 tons of starch annually for domestic use and export. The government is also planning processing plants for salt and palm oil, to be launched in 2003.

"A new Export Development and Investment Fund provides financial support through designated commercial banks to enterprises engaged in export production"

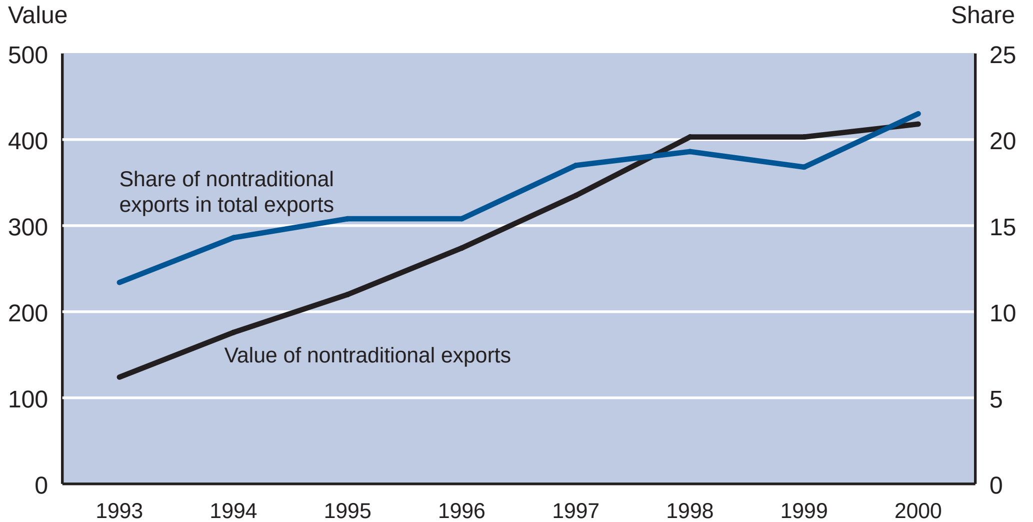
A new Export Development and Investment Fund provides financial support through designated commercial banks to enterprises engaged in export or export production. In 2002 about 23 corporate exporters and export producers benefited from this scheme, but disbursements have been slow. In 2002 it granted about 10.3 billion cedis ($12.5 million), less than a fifth of the total available facility of 56.1 billion cedis ($68 million). Two more rural-based initiatives are to be launched in 2003 in oil palm and salt production.

As part of a policy to reduce reliance on donor resources, the government has intensified efforts to attract foreign direct investment. But according to the Ghana Investment Centre, registered foreign direct investments declined from $637 million in 1997 to $234 million in 1999, and further to $180 million in 2001. The main sources are Britain, India, China, the United States, and Germany, in that order. Other sources include Malaysia, Nigeria, and South Africa. From January to June 2002, 26 investment projects were approved, amounting to $12 million, with manufacturing accounting for 50% and services 25%.

Figure 5.8

Nontraditional exports on the rise

Value and share of nontraditional exports in total exports, 1993–2000 (US$ millions and %)



Source: *Economic Commission for Africa, from official sources.*

The National Science and Technology Policy aims to increase public funding of scientific research from 0.3% of GDP to 1.0%. Under the policy the Council for Scientific and Industrial Research will spearhead the country's scientific and technological advancement. The research activities of the institutes that make up the council are being revamped, involving the institutes in private sector programmes. The Cocoa Research Institute of Ghana is propagating new agronomic technology that will boost productivity from 400 kilograms per hectare to 1,350 kilograms in five years, compared with Côte d'Ivoire's 850 kilograms per hectare.

Foreign direct investments declined from $637 million in 1997 to $234 million in 1999, and further to $180 million in 2001

The financing of these projects is still a concern, making it important to ensure their long-term viability by not oversubsidizing them.

Social developments

Between 1991 and 1999 the incidence of poverty declined by 12%. Life expectancy improved from 49 years to 57. And between 1970 and 2000 literacy increased from 51% to 72%, with youth literacy rising from 75% to 91%.

But the country still ranks among the lowest quartile on the UNDP global Human Development Index (UNDP 2002b). And between 1992 and 1999 poverty increased in 3 of the country's 10 regions: central, northern, and upper east. With population growth at 2.8% a year, a GDP of 2.7–5.0% annually since 1985 has generated only marginal growth in per capita income. Government expenditures per capita on health and education have been low, a result of revenue limitations imposed by more than 30 years of stagnation in real per capita GDP and the continuing expansion of the underground economy. But they have more than doubled over the past five years (table 5.7).

Poverty reduction—2 million lifted out of poverty in the last decade

The incidence of poverty declined from about 52% in 1992 to about 40% in 1999 (Ghana Statistical Service 2000). Much of this decline was due to increases in agricultural production and in the producer price of cocoa. The incidence of poverty has historically

Table 5.7

Expenditure shares of education and health, 1998–2002 (%)

Item	1998	1999	2000	2001	2002[a]
Social services	14.0	22.2	18.3	25.2	34.7
Education	10.6	14.5	12.8	17.5	24.1
Health	2.7	6.1	4.2	6.8	9.3
Recurrent budget (billions of cedis)	2,862	3,226	4,487	5,034	6,848

a. Estimated.

Source: *Economic Commission for Africa, from official sources.*

been higher in rural areas, and poverty reduction has been faster in urban areas as well. The ratio of rural to urban poverty, 2.29 in 1992, leapt to 2.55 in 1999, showing that urban areas benefited more from the economic growth.

> *Between 1992 and 1999 poverty incidence declined in all regions except the central, northern, and upper east*

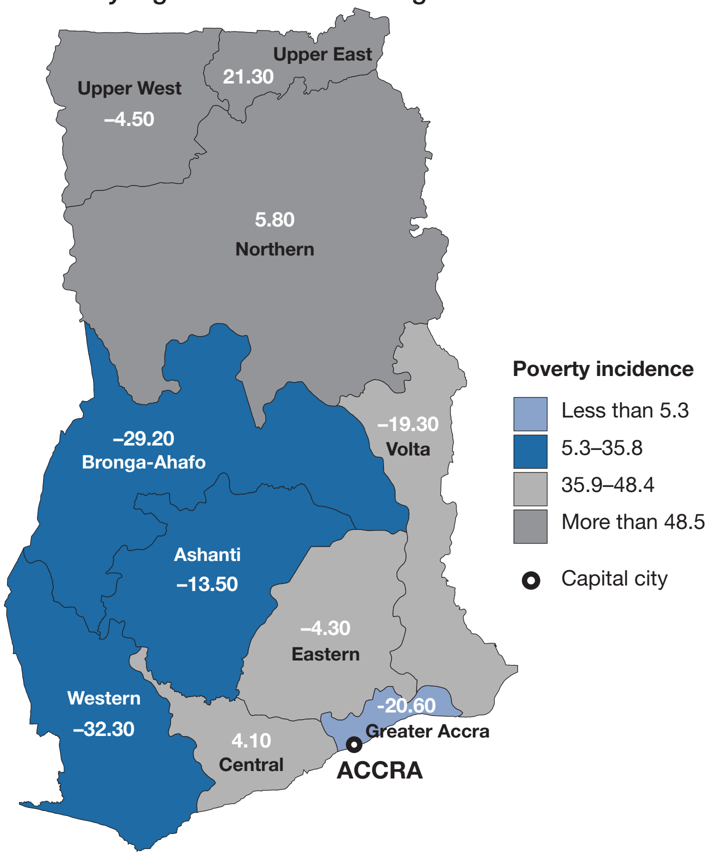
Between 1992 and 1999 poverty incidence declined in all regions except the central, northern, and upper east, falling sharply in the western region, Bronga-Ahafo, and Greater Accra (figure 5.9). Poverty is much more prevalent in Ghana's savannah zone (northern and upper regions) than in the southern part of the country (figure 5.10). The north has not yet benefited much from the improved macro environment.

Differences in access to basic infrastructure and health services may explain the geographical variation, with the distance from the coast and the center of economic and political power costing dearly. The pervasive poverty in the north can also be attributed to the decline in rice production in the region with the removal of government

Figure 5.9

Geography matters for poverty in Ghana

Poverty incidence by region in 1999 and change in incidence since 1992 (%)



Note: Numbers on map indicate change in poverty incidence between 1992 and 1999.

Source: Economic Commission for Africa, from official sources.

support for irrigation and processing facilities. Local rice now accounts for less than 20% of national consumption, compared with 60% in the 1970s and 1980s. Poor people in rural areas lack access to alternative employment opportunities and credit facilities.

The regional disparity in poverty also reflects the absence of a concerted national programme to improve livelihoods for disadvantaged regions or vulnerable groups. The northern and upper savannah regions should be most favoured for targeting roads, infrastructure, health services, and education. What happens to poverty in Ghana's north matters for overall poverty reduction because more of Ghana's poor live in that region. The Ghana Poverty Reduction Strategy attempts to address this regional imbalance in the distribution of basic services (box 5.6).

> *"Differences in access to basic infrastructure and health services may explain the geographical variation in poverty—distance from the coast and from the center of power costs dearly"*

Education and employment—primary enrolment up, secondary and higher education down

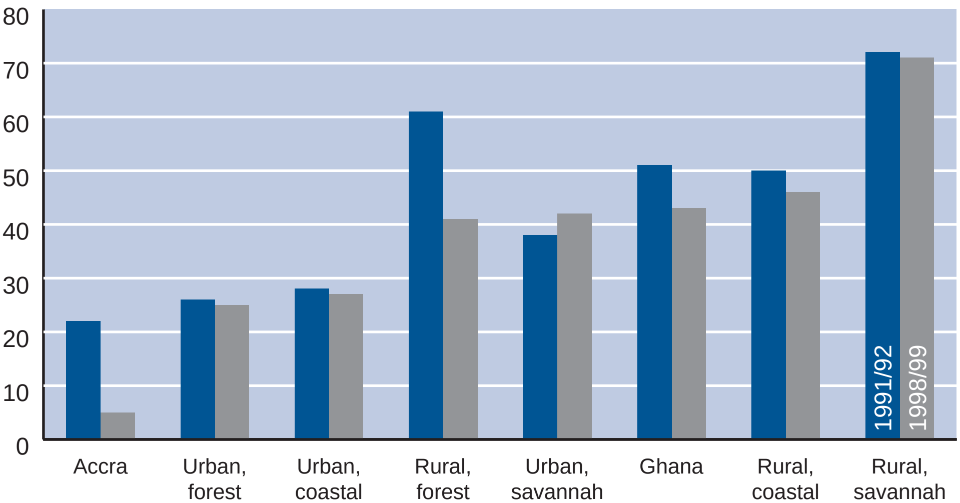
The government has a programme to establish and rehabilitate primary schools in every rural community. Under its nonformal education programme, the government has focused on improving the literacy of the adult population in rural areas, especially of young women.

Between 1989 and 1992 there was a broad increase in primary enrolment, especially among girls, with total enrolment climbing from 79% to 88%. But by 1998 enrolment had slipped to 84%, with female enrolment at 71%. This decline is generally attributed

Figure 5.10

Poverty higher in rural and savannah areas

Poverty incidence, 1991/92 and 1998/99 (%)



Source: *Economic Commission for Africa, from official sources.*

to budgetary constraints and the perceived lower quality of public schools relative to private schools. Under the Free and Compulsory Universal Basic Education policy, launched in 1995, the government is seeking to enrol every child of primary school age by 2005.

Box 5.6

Key pillars of Ghana's Poverty Reduction Strategy

Supply-side objectives

Macroeconomic environment

- Lower inflation and maintain competitive exchange rate.
- Reduce public domestic debt, bring down interest rates, and facilitate credit to small enterprises.
- Adjust prices and restructure enterprises consistent with poverty reduction.

Increased production and employment

- Promote agriculture, agro-processing, nontraditional exports, and employment.
- Improve environment for private sector development.
- Provide skills training and entrepreneurship development for youth.

Governance and institutional reform

- Enhance the cost effectiveness of public expenditure through improved budget preparation and expenditure management.
- Reform government administration by enhancing the capacity of the civil service and rationalizing the structures of central management agencies.
- Ensure wider participation of local communities in decisionmaking by increasing the leadership role of district assemblies.
- Strengthen transparency and accountability, with zero tolerance of corruption.

Disparities in access to services

Equitable human resources development

- Increase access to education by improving school quality and infrastructure in the poorest regions and establishing partnerships with nongovernment actors.
- Improve health care by bridging equity gaps in access to health and nutrition services, ensuring sustainable financing arrangements that protect the poor, and enhancing efficiency in service delivery.
- Reduce the incidence of HID/AIDS and provide support for people living with HIV/AIDS and their families.
- Increase access to safe water and strengthen environmental health.

Programmes for the excluded and vulnerable

- Expand the coverage and effectiveness of essential services for the poorest groups and geographical areas.
- Develop systems that enforce protection of rights, especially for children and women.
- Increase partnerships with nongovernmental organizations.

Source: *Ghana 2001a.*

There is significant inequality in the distribution of educational facilities among the 10 regions and between rural and urban areas. Literacy and enrolment rates are lowest in the northern regions, where few parents can meet the costs of schooling. Poor conditions in the schools, perceived low quality and relevance of school curriculum, and lack of teachers also contribute to low enrolments (box 5.7).

Access to secondary and higher education is declining, because of inadequate classrooms and residential facilities (box 5.8). At the higher education level less than 40% of qualified applicants were admitted in 2001, compared with 60% in the early 1990s.

"In the three poor northern regions (northern, upper east, and upper west) only 2% of schools are privately owned"

Incomes are higher in the industrial sector than in agriculture or services, but access to employment in this sector is limited to the educated. Of the 950,000 people registered as unemployed in a November 2001 survey, more than 60% had a basic education or less. Of the rest 1% had a higher education degree, 16% were postsecondary technical or vocational graduates, and 19% were "O" level, commercial school certificate, or senior secondary school certificate holders.

About 15% of primary schools are privately owned, though they are concentrated in the more urban regions: Greater Accra, Ashanti, and western. In the Greater Accra region about 42% of primary schools are privately owned, while in the three poor northern regions (northern, upper east, and upper west) only 2% of schools are privately owned. The concentration of private primary schools in urban areas reflects the greater ability to pay. Another factor is the lack of social infrastructure in northern areas, which makes them unattractive to teachers and other educational workers.

Box 5.7
A tradeoff between child labor and school attendance?

There are claims that eliminating child labor would improve economic performance in poor countries by improving human resource development. A recent study uses cross-section data from Ghana on 3,374 households to address the question. It finds that after accounting for differences in effects by region (given the different climatic patterns of northern and southern Ghana) and time of year, there is a significant tradeoff between child labor and schooling. An hour of child labor reduces school attendance by approximately 0.38 hours. This tradeoff is more pronounced for boys than for girls.

To see whether poverty is important in determining child labor, the authors divided the sample into three income groups. The analysis suggests that poverty does not determine child labor.

The policy implication for Ghana is that a program such as the Food for Education Program in Bangladesh (which feeds school children to encourage parents to send them to school instead of work) may not be the first-best policy. The study does not try to explain why households make these decisions—for example, because of poor school quality (low demand) or lack of functioning labour markets. These questions are left for future research.

Source: *Boozer and Suri 2001.*

Private secondary schools, though increasing steadily, still account for only a small share of enrolment. The proportion of students enrolled in private secondary schools increased from 1% in 1992 to 7% in 1998. Private provision is highest in technical and vocational education, where government provision is limited. The private sector has been active in general education, but suffering from government intrusion, many private schools folded up.

"Private secondary schools, though increasing steadily, still account for only a small share of enrolment"

Over the last 10 years the number of private universities has increased from zero to four, with three others waiting for accreditation. In addition, privately owned institutes have been accredited to run degree courses for foreign-based universities. The National Accreditation Board has been strengthened to oversee activities in private higher education.

Health, nutrition, and HIV/AIDS—urban bias in health provision

Ghana's health sector policy seeks to improve service delivery, establish sustainable financing arrangements that protect the poor, and promote equity, with a special focus on reducing geographical disparities and addressing diseases that affect the poor. Health expenditures are low at 1.8% of GDP, but life expectancy, infant and adult mortality rates, and child immunization rates are much better than the average for Sub-Saharan Africa. For instance, the maternal mortality ratio is 210 per 100,000 live births, compared with 530 or more for most countries in the region.

Box 5.8

Numeracy and literacy decline

Ghanaian policymakers have appreciated the importance of education for economic development. For example, the 1987 Education Sector Reform Program was established to improve the efficiency, quality, and relevance of Ghanaian education. Part of the reform was an increase in access to education and a shortening of pre-university education from 17 years to 12. Additional reforms were outlined in *Ghana—Vision 2020*. Among specific education goals are achieving universal primary education and increasing access to secondary and higher education. To turn the *Vision 2020* into reality the government launched the basic education sector improvement program in 1996. The focus is on promoting education by increasing education expenditures with special attention to school facilities and teacher housing in rural areas.

Have these policy interventions had the desired effect? No. A recent empirical study finds school quality increasing initially but then declining. The study finds evidence that cultural norms and religious background are important determinants of schooling. Ghanaians with Christian backgrounds are more likely to be literate than Ghanaians with other religious backgrounds. The study finds evidence of gender bias, with women less likely to be literate than men, and asymmetries in literacy and cognitive skills between rural and urban areas and across regions. The findings suggest that future policy design should be particularly targeted at girls and at groups with non-Christian religious backgrounds in rural areas.

Source: *Blunch 2002.*

Between 1970 and 2000 infant mortality fell by half and under-five mortality by 40%, while life expectancy at birth increased by 14%, but the gains have not been evenly distributed. Health infrastructure is concentrated in urban areas in the south, a bias that is reflected in weaker health and nutrition outcomes in the north. In northern Ghana under-five mortality is three times as high as the national average, and the proportion of undernourished children is 34-38%, well above the 25% national average.

> *Life expectancy, infant and adult mortality rates, and child immunization rates are much better than the average for Sub-Saharan Africa*

Malaria is still the leading cause of illness, but its incidence declined from 44% in 1990 to 41% in 1998. Various programmes have been launched since 1993 to prevent and treat malaria including the five-year National Malaria Control Programme (1993–97) and the Accelerated Malaria Programme (1997) launched in 30 districts to focus on case management.

HIV/AIDS prevalence has been on the rise. Among women tested for HIV at antenatal clinics, 3% were positive in 1998, compared with 1% in 1990. In 1999 an estimated 3.6% of the adult population tested were HIV-positive, with the eastern, western, and upper east regions having the highest number of cases. Of the reported cases, 62% were women.

To improve health delivery, a community-based Health Planning and Services Strategy is moving health facilities to community locations, developing sustainable voluntarism and community health action programmes, empowering women and vulnerable groups, and improving interaction among health providers, households, and the community.

To increase access to health care in rural areas under direct management of district assemblies, the government has also launched the National Health Insurance Scheme, on a pilot basis, in 42 of the 110 districts (box 5.9).

A major issue is the exodus of trained medical and nursing staff, particularly to the United Kingdom and the United States, due to low pay and poor facilities. The budget allocation to the health sector has been very small, if increasing in recent years. In 2002 the health sector took 9.3% of public expenditure, up from only 2.7% in 1998. Even so, drastic means are needed to sustain the sector. The two teaching hospitals in Accra and Kumasi, as well as the 10 regional hospitals, need financial injections to rehabilitate old structures and build new ones.

Without any deliberate policy, the public and private sectors in Ghana have shared health service provision for a long time. Private providers include individual health operators, generally clinics and church missions that establish clinics and larger hospitals.

As with education, private participation in the health sector is concentrated in the urbanized regions, although mission hospitals and clinics focus on poorer regions.

Institutional reforms—public service in crisis

A major impediment to effective economic performance in the last decade or so has been poor management of public finances. Lack of accurate and timely information on budget allocations, commitments, and actual expenditures has undermined the efficient allocation of scarce resources (IMF and IDA 2002). It has also impaired control of expenditures by the numerous government ministries, departments, and agencies. In 2000, for example, the Controller and Accountant-General's Department failed to capture expenditures equivalent to about 6.6% of GDP (CEPA 2002).

> *"Lack of accurate and timely information has undermined the efficient allocation of scarce resources"*

Several attempts to improve the situation have had little impact, largely because of the lack of political commitment and capacity (box 5.10). In 1995 the Ministry of Finance initiated the Public Financial Management Reform Programme and later such related processes as the integrated payroll and personnel database, the medium-term expenditure framework, and the budget and public expenditure management system. But at the end of 2002 the government was still grappling with the same issues as in 1995: weak capacity, inaccurate data, lack of reconciliation of fiscal and banking data, lax internal audit systems, ghost names on the payroll, substantial payment arrears, and weak coordination between government units and the Controller and Accountant-General's Department.

Box 5.9

Mutual health insurance scheme in Ghana

Poor health is implicated in Ghana's high incidence of poverty. In rural areas the average number of outpatient contacts per person per year is 0.19–0.23, compared with the national average of 0.34–0.44. The low level of health care use in rural areas contributes to the high national burden of preventable disease. Over the long term, health investments that increase the use of health care will improve health and productivity, increasing incomes and reducing poverty.

The government is seeking to increase health care, especially among the poor. As part of the Ghana Poverty Reduction Strategy local health insurance schemes will be established, each targeting households in defined poor communities, such as villages or districts. Households will make regular payments into a government-managed fund, with payouts made to finance health care for members. The aim is to limit illness related to income shocks in poor households.

The scheme has kicked off in a few pilot sites. Early evidence is mixed. The scheme has succeeded in pooling a significant number of people and thus promises to increase access to health care. However, problems exist. Administrative and financial capacity is a problem. Most of the target population is poor, with low or irregular incomes, thus resource mobilization remains low. In many African communities, risks co-vary, with further implications for the sustainability of the scheme. It is very unlikely, therefore, that the scheme will succeed in providing universal (or near universal) coverage for Ghanaians any time soon.

Source: *Arhin-Tenkorang 2002.*

The Financial Administration Bill presented to parliament in 2002 attempts to strengthen enforcement of expenditure rules (Budget Statement 2003). But the poor public financial management has to be dealt with expeditiously. Ghana faces deep constraints in revenue generation and cannot afford such egregious inefficiencies in public resource use. The public service in Ghana, too weak to support the government's development agenda, appears to be in crisis.

Box 5.10

Why so little to show for 20 years of reforms?

Over the past 20 years Ghana has not been able to accelerate growth beyond an average of 4% despite huge transfers of resources from the developed world. Per capita official development assistance averaged $30 a year in the 1980s and 1990s, compared with less than $10 in the 1960s. But real GDP growth exceeded 5% in only 3 of the 22 years after 1980—8.3% in 1984, reflecting mainly the recovery of agriculture following a year of drought in 1983, and in 1988 and 1991. Manufacturing's contribution to GDP has shrunk by about 40%, from 15% in the 1970s to 9% in 2000.

Only a few reforms have shown positive results. Reforms in the cocoa sector have helped reverse declining production, while banking reforms have reduced excessive exposure. But other strategic interventions—such as trade liberalization, privatization, and industrial policy—have not had the desired effects on poverty reduction, employment, the structure of industry, and the long-term sustainable development of the economy.

Why has economic growth not taken off after 20 years of reform and external assistance? Indeed, why has the quality of growth been so poor, with little tangible benefit for the population? One compelling reason is that growth has been driven largely by capital accumulation from public sources and not by private investment. The increase in capital was not accompanied by significant improvements in total factor productivity—a key determinant of growth. The lack of improvement in total factor productivity means that the capital was inefficiently allocated. High inflation, excessive government spending, and deficit financing through high-yielding treasury bills all acted together to further depress investment and growth.

Weak government commitment is another reason. Since 1992 the pace of the reform process has been influenced by the electoral cycle, slowing in election years and picking up in the post-election period.

The undeveloped aggregate supply capacity of the economy has been another binding constraint, one the reforms have yet to deal with directly. Agriculture, which accounts for about 36% of GDP, is largely rain-fed, and at least one-quarter of production is lost because of inadequate storage facilities. The average age of industrial equipment is 30 years, while transportation networks, energy supply, and telecommunication services are inadequate. Persistently high interest rates constrain access to credit. And the weather still determines the contribution that 70% of the major sources of GDP make to growth annually: rain affects the supply of electricity from the Volta River Authority, with detrimental affects on manufacturing and some service industries.

Source: *Economic Commission for Africa, from official sources.*

Two excerpts from the Ghana Poverty Reduction Strategy reinforce this assessment (2001, p. 109):

> It would appear that the totality of the public sector reform program might be beyond the capacity of the available human and financial resources to plan and implement. . . .
>
> However, the reform process cannot proceed effectively without sustained and palpable political commitment, the enforcement of agreed proposals for reform from a political and official level, and provision of adequate resources.

"In economic management and coordination the institutional structures for policymaking are fragmented"

Low compensation and ineffective management of the public service—including the absence of a strategy for human resources development, use, and retention—were singled out as the prime causes of the malaise.

In economic management and coordination the institutional structures for policymaking are fragmented among the Ministry of Finance, the Ministry of Economic Planning and Regional Integration, the National Development Planning Commission, and the Economic Management Team of the cabinet. This has led to duplication of roles and functions and unclear decisionmaking, creating tensions, misunderstanding, and inconsistency. Even responsibility for such programs as those funded under HIPC debt relief is unclear.

Oversight is also diffused and ambiguous. Financial monitoring and evaluation functions clearly belong to the Ministry of Finance. But the ministry also has a monitoring and evaluation unit for all development projects implemented across all sectors of the economy, including highways, which is clearly inappropriate. Monitoring and evaluation of development projects and programmes, including District Assembly plans, should be strengthened in the sectoral ministries, with oversight by the Ministry of Economic Planning and Regional Integration, which now has an understaffed Monitoring and Evaluation Unit.

Further diffusing oversight responsibility are the monitoring and evaluation responsibilities of the National Oversight Committee in the Office of the Vice President, apparently responsible for the National Institutional Renewal Program. The planned Office of Policy Coordination, Monitoring, and Evaluation in the Office of the President, under the Chief of Staff, will only worsen the fragmentation and diffusion.

Ad hoc approaches to planning and budgeting and lack of coordination and consultation weaken economic policy formulation. Particularly problematic is the ineffectiveness of the Economic Management Team. One of four main committees of the team is charged with matters relating to the economy and finance. Chaired by the senior minister, it includes 14 ministers with core economic and finance portfolios or sectoral responsibilities. Meeting at least once a week, the team is responsible for economic policy coordination and management through peer examination of proposals. The cabinet secretary and three administrative officers provide the only secretariat support.

Given its structure and composition, the Economic Management Team cannot debate key economic and financial strategies and policies of government. Nor is it the right place for tracking key developments and trends, including monitoring the implementation of World Bank and IMF programs and World Trade Organization-related matters. With no clear terms of reference and no administrative instructions, it operates in a loose de facto mode. Combined with weak technical support, these factors hamper its effectiveness, leaving major policy outputs of the government in a state of limbo or in contradiction, with no apex agency to coordinate and reconcile positions.

> *The medium-term outlook is cautiously optimistic because of the government's demonstrated commitment to establishing the conditions for faster growth*

Macroeconomic scenarios for the medium-term expenditure framework program, under the Ministry of Finance, are operationalized before being reconciled with the Poverty Reduction Strategy macro-framework under the Ministry of Economic Planning and Regional Integration. A last-minute recognition of this failure forced an eleventh hour first-ever meeting of economists from the two ministries in 2002. But the Bank of Ghana was not party to setting macro-targets, including the inflation target for the budget. Nor was it part of the Poverty Reduction Strategy process, except towards the end when project costs were required. There is thus a potential clash of medium-term expenditure framework and Poverty Reduction Strategy objectives, targets, and commitments.

Medium-term prospects

The medium-term outlook is cautiously optimistic because of the government's demonstrated commitment to establishing the conditions for faster growth, as reflected in greater fiscal discipline and export development over the past two years. The rising external inflows, from cocoa, gold, and remittances, will also help stabilize the external balance and the exchange rate.

What about the downside risks? There is danger of lax monetary and fiscal policies in the runup to the next general election in 2005. The loss of macroeconomic credibility, due to the high levels of domestic debt and the failure to meet convergence criteria, could crowd out private investment. Regional contagion due to conflict in neighboring Côte d'Ivoire could increase the risk premium for foreign and domestic investment. Also tied to conflict are the possible inflow of thousands of refugees across the western border and the loss of incomes and employment to the thousands of Ghanaians resident in Côte d'Ivoire.

The overall impact of the Côte d'Ivoire crisis on the Ghanaian economy could be favourable, however, since many small and medium-size enterprises in Côte d'Ivoire might relocate to Ghana. Already, Ghana is benefiting as a new transit port for such landlocked countries as Burkina Faso and Mali. Growth of real GDP is projected to increase to 4.9% in 2003, largely due to continuing good performance in agriculture and increased real estate development and construction activities.

But the medium-term prospects for macroeconomic stability may deteriorate, due to the pressures on domestic prices from the recent increases in petroleum prices. Inflation is projected to rise to about 18% in 2003, well above the target of 8%, and fall back to the 2002 level of 13% by 2004. The external accounts may deteriorate, partly reflecting the oil price increase, with the current account balance projected to deteriorate to about 5–6% of GDP in 2003.

A major challenge is dealing with the debt overhang of the Tema Oil Refinery, which is compromising financial stability

A major challenge is dealing with the debt overhang of the Tema Oil Refinery, which is compromising financial stability. The debt is largely responsible for the 93% increase in petroleum prices in January 2003. Emanating from the petroleum prices is the more serious challenge of containing inflation by sustaining confidence in the economy and reducing inflationary expectations. The minimum wage rate was increased 23%, to 9,200 cedis in February 2003, to accommodate the expected rise in the cost of living from the petroleum price increases. The impact of higher petroleum prices on the rural poor still has to be addressed.

The public services reform programme, particularly for the public financial management system, must be vigorously pursued, to promote a stable fiscal environment for private sector development and enhance implementation capacity for the country's poverty reduction and related social programmes.

Notes

1. For example, government expenditure per university student declined from $2,300 a year in 1990 to $900 in 1999, and to $400 in 2000, and spending per polytechnic student declined from $180 to $74 (World Bank 2001).

2. The other cell phone operators are Mobitel Ghana, Spacefon, and Ghana Telecom (One Touch).

3. The Monetary Policy Committee is made up of the governor, as chairman, the first and second deputy governors, the director of research, and the director of the banking department, all of the Bank of Ghana; Dr. Nii Kwaku Sowa of the Centre for Policy Analysis (CEPA), Ghana; and Dr. Bartholomew Armah of the Institute of Economic Affairs, Ghana.

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