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Synopsis: IS THERE FISCAL SPACE FOR CAADP IN GHANA?

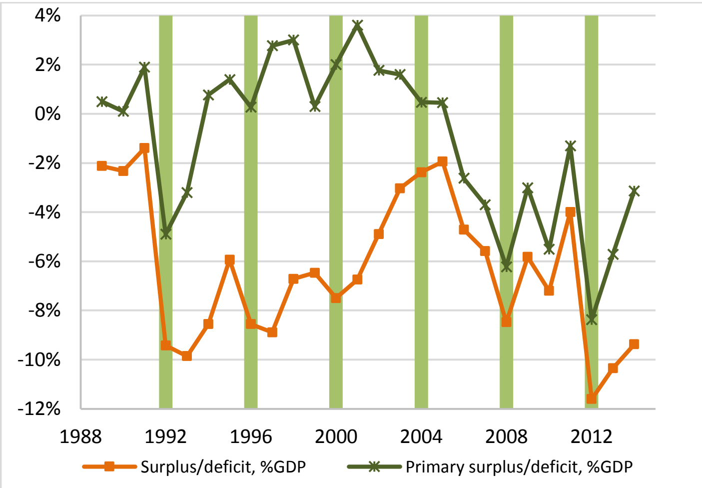
Stephen D. Younger

In 2009, Ghana was one of the first African countries to accept the Comprehensive Africa Agriculture Development Programme (CAADP) target of committing ten percent of government expenditure to agriculture. Despite this commitment, Ghana remains far short of that goal. In recent years, spending on agriculture has increased, but only to about 3.5 percent of total expenditures (Benin 2014; ReSAKSS 2015). To attain the CAADP target, Ghana needs to spend an additional 6.5 percent of total expenditures, or about 2 percent of GDP, on agriculture. Yet Ghana also finds itself needing to reduce an historically large and persistent budget deficit of about ten percent of GDP. In such difficult fiscal times, is it possible for Ghana to meet its CAADP commitment?

The Fiscal Situation - Getting into Trouble

Figure 1 shows the overall and primary surplus for the past 30 years in Ghana. The dramatic deterioration in 2012, an election year, is obvious, but not unprecedented. What is more unusual about the current crisis is its persistence, with the deficit likely to remain around 10 percent of GDP through 2015, four years after the deficit ballooned. This has been possible because the government found it relatively easy to borrow in commercial markets, both domestic and foreign. Heavily Indebted Poor Countries (HIPC) debt relief, a revaluation of GDP, and the prospect of future oil revenues all made the government appear more creditworthy. But the extremely high interest rate needed for Ghana's most recent Eurobond issue suggest that that perception has changed. Ghana is going to find it difficult to borrow, and must reduce its deficit considerably.

Figure 1—Fiscal Surplus/Deficit, Percent of GDP



Source: IMF, various publications, cited in Younger (forthcoming)
Notes: Election years highlighted

We analyze the sources of the fiscal deficit, highlighting the following changes between 2010 and 2012: an increase in the public sector wage bill of about 4 percent of GDP, more than half of which reflected arrears clearances associated with the transition to the single spine salary structure; clearance of other arrears of about 2.5 percent of GDP; an increase in electricity subsidies of about one percent of GDP; and an increase of about one percent of GDP in the "reserve vote," a catch-all line item that may reflect election-oriented expenditures.

Looking forward, the good news in these data is that most of these expenditure increases are reversible: arrears need only be cleared once, and government has moved away from subsidizing electricity. Indeed, Figure 1 also shows that the *primary* surplus did improve significantly after the election. But the overall deficit improves much less[1], because interest payments have increased by between 3 and 4 percent of GDP, a consequence of the persistent deficit. This is important because these payments are inflexible and cut down on the fiscal space available for other expenditures, including agriculture. So, while it would seem straightforward to eliminate much of the expenditure that initially drove the deficit, the interest payments remain.

On the revenue side, government highlights a decrease in donor grants, which ran between 3 and 4 percent of GDP in the 2000s, in part reflecting HIPC relief, but fell to 1.5 percent of GDP in 2012 and less than one percent thereafter. Understanding the source of this decline is important for future fiscal policy. One explanation is that this is a permanent decline resulting from donor countries' own fiscal straits and Ghana's graduation to middle-income status. If this is true, Ghana cannot count on increased grant support to help work its way out of the current crisis. On the other hand, the declines may be cyclical as donors withheld support in an election year for fear that it would not be spent wisely, and in subsequent years as a protest over the size of the deficit. If this is true, a concerted effort to reign in the deficit may result in some degree of increased grant support from donors.

Despite these declines in donor support, it is important to note that total revenues plus grants increased steadily through 2012 by about 3 percent of GDP compared to 2010, and have held up since then. Roughly half of this reflects increased oil-related income, which increased from 1.0 percent of GDP in 2010 to 2.5 percent in 2014.

The Fiscal Situation - Getting Out of Trouble

Government has a detailed plan to restore macroeconomic stability that has been agreed upon with the International Monetary Fund (IMF) under the auspices of a 3-year Extended Credit Facility signed in late 2014. Table 1 gives key elements of the fiscal plan along with its projections for some macroeconomic variables. The program's overall fiscal target is to reduce the deficit

[1] Indeed, other sources show no improvement in the overall deficit (Ministry of Finance 2015).

Table 1—Government of Ghana macroeconomic program, 2015-2017, agreed with IMF

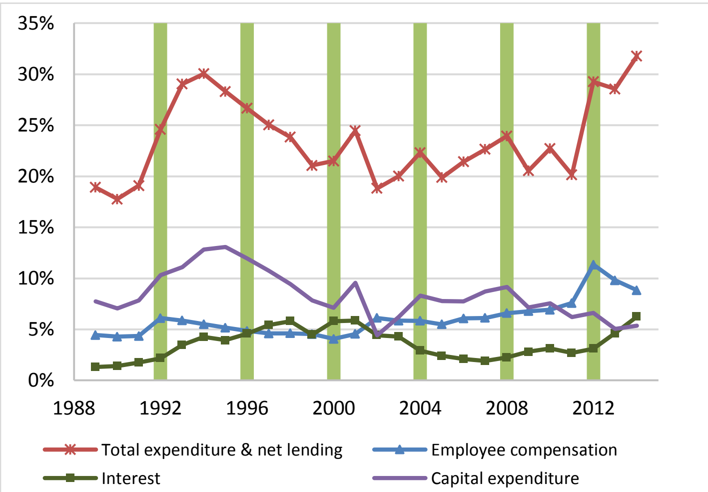
			Est	Program			Change, %	
	2012	2013	2014	2015	2016	2017	2012-17	2014-17
Growth Rate (%)								
Real GDP	8.0	7.3	4.2	3.5	6.4	9.2		
Real non-oil GDP	7.3	6.7	4.1	2.3	4.7	5.5		
CPI (annual average)	7.1	11.7	15.5	12.2	10.2	8.4		
Percent of GDP								
Gross capital formation	31.0	22.4	24.7	23.6	24.7	25.4	-5.6	0.7
Government	6.1	4.8	5.6	4.6	4.7	4.6	-1.5	-1.0
Private	24.9	17.6	18.5	18.5	19.5	20.5	-4.4	2.0
Current account balance	-11.7	-11.7	-9.2	-7.0	-6.2	-4.9	6.8	4.3
Central government revenue	18.5	16.5	18.4	19.2	19.6	20.0	1.5	1.6
Oil revenue	1.3	1.7	2.5	0.9	1.5	2.2	0.9	-0.3
Grants	1.5	0.5	0.7	1.4	1.2	0.9	-0.6	0.2
Central government expenditure	30.1	26.8	27.8	26.7	25.4	23.7	-6.4	-4.1
Compensation of employees	12.0	10.9	9.7	9.5	8.6	7.9	-4.1	-1.8
Purchases of goods and services	1.8	1.0	1.6	1.1	1.0	1.0	-0.8	-0.6
Interest payments	3.2	4.6	6.2	7.2	6.1	5.6	2.4	-0.6
Subsidies	1.1	1.2	0.4	0.0	0.0	0.0	-1.1	-0.4
Other recurrent †	3.8	2.5	2.3	0.9	1.4	1.3	-2.5	-1.0
Net acquisition of nonfinancial assets	4.8	4.5	5.4	4.6	4.9	4.5	-0.3	-0.9
Overall balance	-11.6	-10.4	-9.4	-7.5	-5.8	-3.7	7.9	5.7
Primary balance	-8.4	-5.7	-3.1	-0.3	0.3	1.9	10.3	5.0
Central government debt	49.1	55.1	67.6	69.6	67.5	62.6		

Source: IMF (2015)
Notes: † "Other recurrent" includes arrears clearances

to 3.7 percent of GDP by 2017 (from 11.6 percent in 2012 and 9.4 percent in 2014) and to bring the primary balance back to zero immediately and to a small surplus by 2017. Given the growth assumptions, this will allow the debt-to-GDP ratio to begin to decline.

To achieve this will require significant reductions in expenditures: reductions equivalent to 6.4 percent of GDP compared to 2012, the beginning of the crisis, and by 4.1 percent compared to 2014, the most recent pre-program year. The largest share will come from reduced expenditures on employee compensation. Given that wages were a main source of the fiscal deficit, this makes sense. However, the overall cut is not very ambitious – the program leaves the wage bill at 7.9 percent of GDP in 2017, significantly higher than historical ratios (Figure 2).

Figure 2—Selected Government Expenditures, Percent of GDP



Source: IMF country reports, cited in Younger (forthcoming)

The program also relies on increased tax revenue of 1.6 percent of GDP. Most of this increase comes from imposition of a special 17.5 percent ad valorem tax on petroleum products that had previously paid only excise duties, a step already implemented in the 2015 budget. While met with strong protests, this is a mostly reasonable tax increase. Fuels are more lightly taxed in Ghana than other countries, and taxes on petrol and diesel are progressive even after considering their indirect effects on transport costs and goods and services that use transport (Osei-Assibey, Oppong, and Younger, forthcoming). Taxes on kerosene, on the other hand, are quite regressive and thus less attractive.

Except for a temporary increase in 2015, the program does not envisage grant support returning to 2012 levels.

In all, the program brings the overall deficit to 3.7 percent of GDP and the primary balance to a surplus of 1.9 percent of GDP by 2017, both better than has been the case for most of the past 20 years (Figure 1). Since Ghana has done passably well with deficits of this size, the program would seem to be adequate to restore macroeconomic stability.

Is There Any Further Fiscal Space for Agriculture?

The outline of the existing macro plan would seem to say "no," but a closer examination suggests that the answer should be "maybe, with some luck." The government's current plan cuts most spending, makes optimistic assumptions about growth rates, inflation, and interest rates on government debt, and still only just brings the fiscal and current account deficits to sustainable levels. There does not seem to be room for further spending on social welfare, agriculture, infrastructure, or anything else.

That said, there is one place where the current program is less than ambitious: the public sector wage bill. Figure 2 shows that as recently as a decade ago, Ghana spent only 5 to 6 percent of GDP on employee compensation. That figure is now 9 to 10 percent of GDP, and the current program plans to lower it only to 8 percent by 2017. More aggressive reform seems possible on this front, although it would be politically difficult, probably require significant retrenchment and accompanying severance pay, and take several years to achieve.

A less tractable question is what to expect in terms of donor support. Grants have ranged from one to four percent of GDP over the past three decades. Currently, they are at the lower end of that range, although 2015 should have significantly more grant support in the wake of the IMF agreement. On one hand, Ghana should expect much less grant support as its GDP and oil revenues increase. On the other, Ghana is certainly in a bind currently, and donors have been quite responsive to helping it meet its fiscal difficulties in the past. Further, there is renewed interest in agriculture in the donor community, so it may be possible to garner increased funds if they are dedicated to that sector.

While the politics of the public sector wage bill are difficult and donor support uncertain, it does at least seem possible that these two sources could yield the fiscal space for the, at most, two percent of GDP in agriculture expenditures needed to meet Ghana's CAADP commitment.

It is also important to highlight an item that will not provide much more fiscal space: oil revenues. The current projection is for oil-related revenues to be only 2.2 percent of GDP in 2017 after the new fields come on line. That is less than the contribution in 2014 because of lower world oil prices.

Increasing revenues also is unlikely to be a wise approach to increasing fiscal space. With revenues around 20 percent of GDP, Ghana is already above average for lower middle income countries (15.4%) and middle income countries (18.1%). So, while there may be sensible administrative reforms to make taxation more efficient, the goal should not be to raise further revenues. In particular, part of the government's program calls for a review of exemptions to the tax code, which is quite sensible.[2] In addition, elimination of cocoa duties, which are regressive (Osei-Assibey, Oppong, and Younger, forthcoming), would be obviously good for agriculture and would have minimal fiscal impact, about 0.2 percent of GDP.

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[2] For example, exemptions to import duties account for about 1 percent of GDP.

INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE
2033 K Street, NW • Washington, DC 20006-1002 USA
T: +1.202.862.5600 • F: +1.202.467.4439
Skype: ifprihomeoffice • Email: ifpri@cgiar.org

GSSP – IFPRI
c/o IWMI, PMB CT 112 • Cantonments, Accra, Ghana
CSIR Campus (Opposite Chinese Embassy) • Airport Residential Area
T: +233 (0) 302 780 716 • F: +233 (0) 302 784 752
gssp.ifpri.info
Contact: Shashi Kolavalli, Senior Research Fellow & Program Coordinator

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