

Ghana's Medium-term Fiscal Challenge: The 2009 Budget Begins a Long Journey

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Projections of African growth for 2009 have hit the hard floor. The global economic tsunami has reached Africa's shores and growth is now projected at 3%, about half the level of the last several years. The oil- and metal-exporting countries, such as Nigeria, South Africa and Zambia, are the hardest hit. But countries like Ghana, Kenya, Tanzania too, are now seeing its effects through the impact on demand for their exports and on remittances. And all countries are experiencing a decline in investments from abroad into their stock markets and real sectors, in some cases a withdrawal of funds from their stock markets, as in Ghana.

In its review of the African economic situation published last week, the IMF writes:

The gains of the past decade, during which many countries in sub-Saharan Africa saw sustained high rates of economic growth and rising income levels, are at risk....Some countries have the space for fiscal easing. They need to respond by targeting the poor and putting in place social safety nets. But some others have fiscal constraints and need to act carefully in order to protect their macroeconomic gains."

Ghana falls squarely in the second category: the fiscal situation has been deteriorating since 2006 when the deficit hit a level of 9 percent, and grew to 14.9% in 2008. And yet, the election results also make evident that Ghanaians expect some improvements in the government's social programs for poor people and regions. The 2009 Budget, in seeking to square this circle, has taken a first step in a long journey to recapture the gains of a sound medium-term fiscal stance that will promote stable, shared and sustainable growth. It is a glass that is fractionally full. **Fiscal policy must continue to be vigorously and rapidly strengthened in relation to (i) the global situation, (ii) the domestic economy and (iii) the onset of oil revenues.**

The Global Situation: Ghana needs an improving fiscal stance with a firm medium term target in order to retain access to international financing during the global recession. Private markets will remain shut probably through 2011, and possibly beyond. Non-concessional sources such as the African Development Bank, the World Bank and the IMF are increasing their resource base to support developing countries. An increasingly strong fiscal stance is essential to attract resources from them. The quality of the fiscal stance is absolutely key: it has to be based on reforms that will promote growth and provide social support for poor people.

By programming a fiscal deficit of 9.4%, down from 14.9%, the 2009 Budget signals a move in the right direction, and with a useful if somewhat timid first step. More important is the statement that the medium-term goal is to attain a fiscal deficit of 3% of GDP, and to keep the debt to GDP ratio at or below 60%. These are laudable goals, and observers will be watching carefully to see how these goals will be attained. The 2009 Budget is particularly silent on the actual measures that will get the fiscal deficit down to 9.4% of GDP, and of course also to 3% in the medium term. Clearly, the onset of oil

revenues will mean that the adjustment will not just be focused on the expenditure side, but the devil is in the details, as always.

The Domestic Economy: Fiscal policy—in its quantitative and qualitative aspects-- is the most potent tool of economic policy in developing countries like Ghana. It embodies the key instrument for defining the role of the state in economic policy. The needs of the domestic economy are clear: (a) the fiscal deficit must be reduced significantly in order to help reduce inflation, which hits poor people the most; (b) its reduction will also help to bring down interest rates, which the private sector needs if it is to play the leading role in driving economic growth; and (c) the quality of expenditure and revenue changes must be significantly enhanced, in order to get over the phenomenon of “joyless growth” that characterized Ghana over the 2003-2008 period.

In relation to these goals, the 2009 Budget again takes steps in the right direction on a long journey. Since the 2008 budget deficit contained many expenditures that are unlikely to be repeated in 2009 anyway, such as the oil subsidy when oil prices were at levels like \$147 per barrel, and the additional 3% (of GDP) of public investments that were promoted probably because it was an election year, the 9.4% deficit target is not as ambitious as it appears at first sight. This is in part because of an attempt to make the budget more pro-social through new expenditures such as free school uniforms, the increase in the capitation grant, etc.

The journey from a 9.4% deficit to the medium-term goal of 3% will clearly need a more direct attack on key expenditure reforms that are hinted at in the Budget: public sector reform (including both state-owned enterprises and the wage bill) and the growing menace of subsidies to the energy-related utilities such as VRA, ECG and TOR. In the last 4 years, these two categories have together resulted in a deterioration of the fiscal balance by about 5% of GDP. These two sacred cows will need to be addressed through public debates on (a) who actually gains and who loses from the enormous charge they place on the budget, and (b) how best to foster reforms in them that will promote fiscal soundness while also being pro-social and pro-growth. A long journey is still ahead of us.

The Onset of Oil Revenues: Ghana has many advantages over other African countries in the global economic crisis: cocoa and gold prices promise to remain high, and a new administration has taken over the reins of Government with a mandate for change. Perhaps our biggest resource advantage is the expectation of oil revenues beginning from 2010, estimated conservatively to grow from about 1% of GDP to a peak of about 7-9% of GDP over the subsequent 5 years, and then declining gradually back to about 1% of GDP over the subsequent 15 years. This will have important implications for fiscal policy and pose major challenges on the quality of public expenditures. If we assume that in the first seven years, about two-thirds (i.e 5% of GDP) of this will be spent, that implies **average** growth of expenditures of about 5% a year. Of this 5%, perhaps 4% would be on high return investments in selected projects in health, education and infrastructure on the basis of apolitical cost-benefit analyses undertaken transparently by a new Public Investment Office whose information will be open to the public; and the other 1% for social safety nets; in both cases making sure that the oil producing areas are

well catered for. The other third (2% of GDP) would be saved in a Stabilization Fund, to help counter volatility in oil prices, and allow for a counter-cyclical fiscal policy stance when oil prices fall. **The bottom line is that, while oil revenues will help with the fiscal arithmetic somewhat, unless the two sacred cows of public sector reform and energy-related subsidies to the utilities are addressed, they will fully absorb the entire gain of 5% of GDP that the oil revenue stream will, on average, yield to the economy!**

Conclusion: Ghana's medium term fiscal challenge is a huge one. The onset of oil revenues in 2010 provides an opportunity to boost Ghana's longer term growth potential, if they are managed through strong and transparent institutions such as a Public Investment Office and a Stabilization Fund. But if key reforms related to the public sector and the energy-related utilities are not addressed, they threaten to swallow the bulk of the oil revenues. Or else, the goal of a 3% fiscal deficit in the medium term will not be attained. The 2009 Budget takes a first modest step in this direction. As a wise Japanese once said when told by his gardener that his favorite tree would take a hundred years to grow to its full size: "then we must begin right away!!".

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