PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

May, 6 2015
Report No.: 96592

Operation Name	Macroeconomic Stability for Competitive and Growth
Region	AFRICA
Country	Ghana
Sector	Central government administration (50%); Energy and mining (30%); and Finance (20%).
Operation ID	P133664 and P155550
Lending Instrument	Development Policy Financing: IDA Credit and Policy Based-Guarantee
Borrower(s)	THE GOVERNMENT OF GHANA
Implementing Agency	Ministry of Finance
Date PID Prepared	May 6, 2015
Estimated Date of Appraisal	May 18, 2015
Estimated Date of Board Approval	June 30, 2015
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Country and Sector Background

1.1 Improved macroeconomic stability and more effective public spending are necessary for Ghana to realize its goals of enhanced economy-wide competitiveness and sustained growth. The proposed operation supports the development objectives set out in Ghana's second Shared Growth and Development Agenda (GSGDA II) for 2014-17. The GSGDA II emphasizes the need for structural economic transformation to accelerate poverty reduction and achieve the strategy's overarching objective, "a stable, united, inclusive and prosperous country with opportunities for all." The proposed series advances the government's vision through its two strategic pillars: (i) enhancing the reliability of fiscal policy institutions; and (ii) enhancing the efficiency and effectiveness of public spending. The series is fully aligned with the World Bank's Country Partnership Strategy (CPS) for FY13-16 and consistent with the twin goals of the World Bank Group of promoting shared prosperity and eradication of extreme poverty.

1.2 The proposed operation complements the macroeconomic stabilization program undertaken by the government and supported by the IMF. The program went to the IMF Board on April 03, 2015 and success of the program is crucial to reinforcing macroeconomic resilience, sustaining broad-based growth and ensuring that institutional reforms endure. These objectives are also supported by a number of programs currently being implemented by the World Bank and Ghana's other development partners.

II. Operation Objectives

2.1 The Macroeconomic Stability for Competitiveness and Growth (MSCG1) is the first operation in a new programmatic series of three, following the poverty reduction operation series completed in 2012. The operation combines an IDA Credit and Policy-Based Guarantee (PBG) to cover a securities issuance by the Republic of Ghana. The proposed operation would build upon the achievements of the previous series of DPOs, completed in 2012, with closure of the Eighth Poverty Reduction Support Grant (PRSG-8). To support broader goals of eradicating extreme poverty and shared prosperity the proposed Program Development Objective is to strengthen institutions for more predictable fiscal outcomes and enhance the productivity of public spending. The proposed operation is organized around two strategic pillars, each with three components:

<u>Pillar 1: Strengthen institutions for more predictable fiscal outcomes.</u>

- *Improved control over the wage bill*
- *Better management of government subsidies and arrears*
- *Enhanced debt management capacity*

<u>Pillar 2: Enhance the productivity of public spending.</u>

- *Stronger governance of state owned enterprises (SOEs) and regulators*
- *More effective public investment management*
- *Reinforcing social protection in a context of macroeconomic transition*

2.2 The operation supports the Government's development objectives set out in the Ghana's second Shared Growth and Development Agenda (GSGDA II) 2014-17. The GSGDA II emphasizes the need for macroeconomic stabilization and greater executive efficiency, transparency and accountability to provide an adequate setting for the reduction of poverty and socio-economic inequalities through agricultural, private sector, infrastructure and human resource development.

<u>Pillar 1: Strengthen institutions for more predictable fiscal outcomes</u>

2.3 A policy framework that supports more predictable and transparent fiscal policies and outcomes is needed to reduce volatility in fiscal outcomes and mitigate the deficit bias. With oil and natural gas emerging as new important sources of fiscal revenue, the policy framework needs calibration to absorb the additional volatility arising from various sources, including commodity price shocks and pressures for government to increase public spending and investment. The availability of resources that can be made quickly available without the scrutiny of Parliament, such as the oil and gas resources, can generate a voracity effect, as pressure from corporatist interests, such as organized labor, on the budget increases.

2.4 Ghana's current macroeconomic environment is different than in the mid-2000s when the country experienced a growth boom, and hence, policies and fiscal institutions need realigning. The differences arise from both the external and domestic angles. In the international context, economic growth is sputtering, commodity prices have decreased significantly, and international capital markets are in a flux due to anticipated policy changes in the developed economies. On the internal side, high public debt levels and low international reserves have eroded the ability of the economy to absorb shocks via counter-cyclical fiscal policy or changes in interest rates that could be necessary from a monetary policy perspective. Consequently, policies need to be reoriented towards rebuilding buffers and ensuring that: (i) public spending grows at rates that are commensurate of government revenue growth and availability of funding sources, and (ii) that fiscal risk is managed within a comprehensive strategy that includes risk arising from public guarantees, the currency composition of liabilities; plus any rollover risk arising from the maturity of liabilities. These challenges require institutions that will make fiscal policy more predictable and that ensure that every dollar of public spending is effective in achieving its objectives.

2.5 Support provided by the operation under Pillar 1 will be focused on control of the wage bill, control of Government subsidies and arrears, and enhanced debt management. The proposed prior actions are:

Improved Control over the Wage Bill

- PA-1: The introduction of an Electronic Salary Payment Verification (ESPV) system by ministries in four regions (in four regions (Accra, Ashanti, Northern, Brong Aghafo).

Better Management of Government Subsidies and Arrears

- PA-2: Elimination of all government subsidies for gasoline, diesel and LPG.
- PA-3: The implementation of the 'procure to pay' (P2P) system in all government agencies to manage the use of resources from the Consolidated Fund.

Enhanced Debt Management Capacity

- PA-4: Cabinet approval of a 'Medium-Term Debt Management Strategy' (MTDS) for 2015-17, including provisions for reducing the refinancing risk of domestic debt.
- PA-5: The issuance of draft guidelines by the Minister of Finance for undertaking credit risk assessments prior to the issuance of loan guarantees, on-lending and other debt-related transactions.

Pillar 2: Enhance the productivity of public spending

2.6 To make future growth sustainable, the growth strategy needs to shift from one based on capital accumulation to one based on total factor productivity growth. Recent World Bank analytical work shows that past growth has been driven mainly by capital accumulation and depletion of natural resources. External savings are limited by the volatile nature of international capital markets (investors will not always be so keen to buy bonds from countries with excessive current account deficits and rapid debt accumulation). Domestic savings are very limited on account of the fiscal deficits and the scarcity of household savings.

2.7 Public resources must be used more efficiently to support productivity growth in the private sector, and this requires reform in critical areas of the public sector. International evidence shows a clear association between indicators of government effectiveness and measures of productivity; countries with better standing on measures of government effectiveness have higher productivity levels. Structural reform to enhance government effectiveness are therefore, central to the Government's agenda to crowd-in the private sector and increase productivity. The government's agenda supported by this operation is focused on the areas of public investment management (PIM) and the governance of SOEs and key regulators with the objective of reducing technical and operational inefficiencies to create fiscal space to fund increased investment spending, improved service reliability for the private sector, and enhanced service levels for consumers. Finally there is a need to ensure that public spending is targeted on the poorest households, via targets social protection, as the Government transitions away from universal fuel and electricity subsides.

2.8 Support provided by the operation under Pillar 2 will be focused on: improved SOE governance, improved public investment management and providing social protecting for the poor during the macroeconomic transition. The proposed prior actions are:

Stronger Governance of SOEs

- PA-6: Cabinet approval of a policy paper on the establishment of a single agency responsible for financial oversight of SOEs, including approval of budgets and debt plans.
- PA-7: Terms of reference for governance and performance assessments issued by the following SOEs, regulators, and public trusts: VRA, ECG, GWCL (SOEs); BoG, NPRA, PURC, NIC, SEC (regulators); and SSNIT (public trust).
- PA-8: The timely publication of the Ghana National Petroleum Company's (GNPC) audited financial statements and investment programs approved by Parliament on the

More Effective Public Investment Management

- PA-9: Cabinet approval of an official PIM policy.
- PA-10: The approval of best-practice principles for the governance structure, investment policies and operations of the Ghana Infrastructure Investment Fund's (GIIF).

Reinforcing Social Protection in a Context of Macroeconomic Transition

- PA-11: An appropriation in the 2015 national budget sufficient to cover LEAP payments to 150,000 households.

III. Rationale for Bank Involvement

3.1 After many years of progress, the performance of the Ghanaian economy became turbulent over the past three years. Challenges facing the economy include below potential GDP growth, sizeable and persistent twin macroeconomic deficits, annual inflation rising and peaking at 17 percent, a decline in international reserves, a rise in external debt amortizations and rapid depreciation of the Ghanaian Cedi. Since July 2011 Ghana has been classified as a Lower Middle Income Country (LMIC), following buoyant economic growth, of 6.6 percent per year on average between 2001 and 2013, and a rebasing of the National Accounts in 2010. Ghana's economic success has been underpinned by positive terms of trade shocks, oil and gas discoveries, and capital inflows, and the robustness of democratic institutions. However, given the persistent nature of the shocks and the government's gradualist approach to addressing the imbalances, economic growth fell to 4 percent in 2014, compared to 7.5 percent annual average over the preceding decade, public debt rose substantially, net international reserves of the Bank of Ghana fell, and the medium-term outlook dimmed.

3.2 The proposed operation is complementary to a parallel macroeconomic stabilization program agreed between the Government and the IMF. A successful IMF program is crucial for macroeconomic stability, a prerequisite for sustained growth, and ensuring that the efficiency gains related to this operation's prior actions are not eroded. The most significant risks of the operation relate to whether a sound and stable macroeconomic framework can be maintained, especially as expenditure pressures are likely to mount as the 2016 elections approach. Furthermore there is a risk that the current power crisis and energy rationing continues and undermines the medium-term economic growth outlook.

IV. Tentative financing

4.1 The MSCG1 is first in a series of three Development Policy Financing operations, combining an IDA Credit of SDR XXX million (US$150 million equivalent) and a Policy-Based Guarantee (PBG) of up to SDR XXX (US$400 million equivalent) to cover a securities issuance of US$1.0 billion by the Republic of Ghana. The proposed operation would build upon the achievements of the previous series of DPOs completed in 2012.

Source:		($m.)
BORROWER/RECIPIENT		0
International Development Association (IDA)		150
Borrower/Recipient		0
IBRD		
Others (specify)		0
	Total	150

Note: the operation also provides a Policy-Based Guarantee (PBG) of up to SDR XXX (US$400 million equivalent) to cover a securities issuance of US$1.0 billion by the Republic of Ghana

V. Institutional and Implementation Arrangements

5.1 The MoF would be responsible for the overall implementation, monitoring and evaluation of the proposed operation. Bank supervision will be aligned with the Government's monitoring and evaluation framework for the GSGDA II through the MDBS review process, focusing on the year-long verification process that monitors the implementation of the policies being supported.

5.2 During implementation a series of reports would assist in monitoring progress of the MSCG1: (i) MoF detailed monthly reports on budget developments (revenue, expenditure, financing, as posted on the MoF website) with a lag of no more than six weeks after the end of each month, (ii) MDAs and NDPC annual progress reports, (iii) IMF reporting on the ECF program and Article IV reports, (vii) PFM reform program updates and PEFA assessment reviews, and (viii) official documents (memoranda, gazette) as means of verification of effective policy decisions.

VI. Risks and Risk Mitigation

6.1 The overall risk of the operation is rated 'high', based on assessment using the World Bank's Systematic Operation Risk Tool (SORT). The overall rating is estimated after consideration of nine risk categories. The 'political and governance' and 'macroeconomic 'categories, have 'high' risk. The remaining categories present moderate or low risk. As part of the assessment two types of risk are considered: (i) risks to achieving the intended (positive) results as per the PDO of the operation and (ii) risks of adverse unintended (negative) consequences to the client flowing from the operation. The potential benefits of the proposed operation therefore outweigh the residual risks and warrant IDA's assistance for implementing critical reforms and policy actions in coordination with other development partners, while supporting risk mitigation actions to maximize the sustainability of the reform agenda.

6.2 Macroeconomic risks are deemed high given the extent of fiscal consolidation involved in the program the government agreed with the IMF. Despite a demonstrated willingness for stabilization by the Government there is opposition to increased utilities tariffs and taxes, support for large wage bill increases, and demand for new investment programs financed with current and future oil revenues; each of which having the potential to undermine moves to correct imbalances. There is also a risk of further external and domestic shocks that render reduced fiscal deficits unobtainable.

6.3 Key macroeconomic risks that need to be mitigated are sevenfold. They include: (i) possible slippages in the implementation of the stabilization program would impact adversely credibility and derail the expected fall in interest rates and stabilization of the currency; (ii) the continuation and deepening of the energy rationing would adversely impact growth and inflation projections, which could in turn, undermine the population's support to the government's reform plan; (iii) the high level of debt and its associated debt burden, in an environment with significant downside risks to growth; (iv) implementation of politically challenging measures to manage the wage bill; (v) recurrence of election year over expenditure in 2016; (vi) low international commodity prices. The main risk-mitigating factors are: (a) the agreement of the IMF program overlaps two different presidential periods, ensuring some continuity to prudent macro management. And (b) partial relief to the energy rationing is provided by the Jubilee gas which started flowing, albeit late, by the importation of services from electricity generating power barges and the importation of emergency power units, and by the commencement of new investment in electricity generation by Independent Power Producers (IPPs) as the investment climate improves with the stabilization of the economy.

6.4 Political and governance risks are deemed moderate as are sector strategies and policies and institutional capacity for implementation and sustainability. These risks each relate to whether government has the will and ability to implement the reforms linked to the proposed operation. The reforms government has committed to are challenging and there is an election planned for 2016 that could see priorities shifted to short-term goals during the build-up instead of medium-term reforms. Furthermore if there was a change of government then there is a possibility that national strategies might be revised.

VII. Poverty and Social Impacts and Environment Aspects

7.1 Measures supported by the proposed operation are expected to have a positive impact on poverty reduction. These include: (i) LEAP payments to provide targeted social protection to the poor; (ii) strengthening the management of public finances (current and investment) for improved allocative and operational efficiency of public expenditure which will enhance the capacity to expand coverage and to enhance the quality of public services; and (iii) restoring the financial viability of the electricity sector, which is critical for economic growth and job creation. More broadly, the proposed operation will support the macroeconomic stabilization program, and in doing so reduce the exposure of the poor and the near poor to macroeconomic shocks.

7.2 The elimination of fuel and electricity subsidies could have a negative welfare impact on poor households, with more than half of the impact attributed to inflationary second-round effects. A poverty and social impact analysis (PSIA) of Ghana's fuel and electricity subsidies shows that, in the absence of compensatory policies, eliminating these subsidies could have an adverse impact on poverty. Fuel and electricity price increases compounded by an indirect inflationary effect could reduce households' real income, potentially increasing the poverty rate by five percentage points. However, more than half of the increase in poverty results from the inflationary impact, or second-round effects, of the policy action. This fact underscores the critical role that inflation control and macroeconomic stabilization play in the poverty reduction agenda. The PSIA simulations also show that increasing the size of the LEAP program by the magnitudes targeted in the proposed operation can partially offset the negative effects of eliminating fuel and electricity subsidies. A central lesson derived from this analysis is the importance of avoiding surges in inflation, which tend to occur when such massive price adjustments take place. The abrupt and shock adjustments, are, generally, gestated over periods of postponed policy decisions. In the medium term, however, the balancing of fiscal accounts and the macroeconomic stabilization will make growth more sustainable and hence, supportive of employment growth, and reduce volatility in consumption; both of which are essential for sustained poverty reduction.

7.1 Measures supported by the proposed operation are not expected to have any significant adverse impact on the environment. All of the actions supported throughout the operation are policy-oriented; they do not support direct investment in environmentally impactful investments or involve policy actions with significant environmental consequences. The implementation of measures to improve the predictability of fiscal outcomes and productivity of public spending pose no risk to the environment. Prior actions improve the governance of SOEs, strengthen PFM (including commitment controls), lay the foundations of a public investment management system, are each likely to be environmentally neutral. In the long-run improvements in sector planning, budgeting and financial management may have positive environmental impacts through more reliable and predictable financing for the ministries and line agencies in charge of managing natural resources and the environment. Prior actions relating to the energy sector involve the removal of government subsidies that have resulted in increased prices faced by consumers.

VIII. Contact point

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