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REPUBLIC OF GHANA

**MINISTRY OF FINANCE**
**P. O. BOX M 40**
**ACCRA**

21st MAY, 2015

**DR. JIM YONG KIM**
**PRESIDENT**
**THE WORLD BANK**

Dear Dr. Yong Kim,

**MACROECONOMIC STABILITY FOR COMPETITIVENESS AND GROWTH (MSCG1) DEVELOPMENT POLICY FINANCING (DPF)**

## INTRODUCTION

1. On behalf of the Republic of Ghana, I write to request for the Macroeconomic Stability for Competitiveness and Growth (MSCG1) Development Policy Financing (DPF) from the International Development Association (IDA) to support the policies and programmes outlined in the Ghana Shared Growth and Development Agenda (GSGDA) II for 2014-17. This letter sets out the reform measures that the Government of the Republic of Ghana (henceforth Government) is undertaking over the medium-term.

2. The GSGDA II is fifth in a series of medium-term national development policy frameworks prepared over the past two decades and serves as the operational framework for the President's *Coordinated Programme of Economic and Social Policies, 2014-2020 – An Agenda for Transformation.* To ensure continuity in overall national development the GSGDA II also builds on the predecessor framework, GSGDA I (2010-2013), drawing lessons from its successes and challenges to enhance overall development, management and the transformation agenda that the *Coordinated Programme* represents. Both the Coordinated Programme and GSGDA II in turn are informed by the government's "*Advancing the Better Ghana Agenda*", the Millennium Development Goals, and the President's State of the Nation Address.

3. Medium-term policies and the 2015 Budget have been developed within the broad framework of the GSGDA II, which sets out the Government's vision for: "***A stable, united, inclusive and prosperous country with opportunities for all***". The success of Ghana's structural transformation rests on three strategic interventions, namely: (i) strengthening and deepening the essential elements and institutions of good governance; (ii) promoting export-led growth through products that build on Ghana's comparative strength in agricultural raw materials; and (iii) anchoring

industrial development through prudent use of natural resources based on locally processed value addition.

## MACROECONOMIC PERFORMANCE AND OUTLOOK

4. Ghana has witnessed significant economic growth over the past decade with real GDP growth rising steadily from 3.7 percent in 2000 to 8.9 percent in 2012 before decelerating slightly to 7.2 percent in 2013. Since 2012 the economy has come under severe stress, due to a combination of unfavourable global factors and domestic imbalances, which led to double digit fiscal and external current account deficits. Given these challenges the Government has agreed on a programme with the IMF to restore macroeconomic stability. The Government's Home-Grown Policies and the outcome of the National Economic Forum held in Senchi have been used as vital input for the design of the Programme prepared jointly with the IMF.

5. Over the past two years, policies to reduce the twin deficits have had some successes, including, migration of almost all public sector workers on the central payroll to the Single Spine Salary Structure (SSSS); clearing of all outstanding SSSS-specific salary arrears (circa GH¢3 billion); improvement in the revenue estimation process of the production and sale of crude oil; and demonstration of our ability to raise both domestic and external funds for priority government projects.

6. Notwithstanding these successes, however, our resolve at rebalancing the Budget has been continually tested as the economy has come under additional significant shocks since 2013. The challenges we continue to face include major exogenous setbacks such as the following:

   i. Continued disruption in the supply of gas from the West African Gas Pipeline (WAGP) from August 2012 through August 2014, due to the damage caused to the pipeline. This has had significant adverse effects on power supply, national output, foreign exchange reserves, and tax revenues.
   ii. Fall in gold and cocoa prices has had similar effects and, required sacrifices by our hardworking cocoa farmers as well as Government in the form of curtailed producer price and export duty respectively.
   iii. Sluggish inflow of programme grants from some Development Partners for the third year in succession (about 50 percent below what was pledged to support the budget over the period.)
   iv. A major decline in global prices for oil in 2014.

7. As a result of the impact of some of these shocks, real GDP is estimated to slow down to 4.2 percent in 2014, down from 7.3 percent in 2013. Over the medium-term, real GDP is estimated to grow at an average rate of 6.4 percent while non-oil GDP is projected to grow at an average of 4.2 percent. The Industry Sector is projected to be the lead sector over the medium term with an average growth of 11.4 percent, followed by the Services Sector with 6 percent and the Agriculture Sector with 3.6 percent.

8. Through implementation of the 2015 budget we will continue to pursue the fundamental policies and measures we have been implementing for some time now (via the Home Grown Policy and Senchi Consensus). The medium-term plan includes measures to address the major causes of the twin deficits.

## MACROECONOMIC TARGETS FOR 2015 AND THE MEDIUM-TERM

9. The medium-term fiscal policy of Government will focus on improving the predictability of fiscal outcomes for a smooth near-and medium-term, alongside efforts to enhance the productivity of public spending. The Government is committed to addressing short-term vulnerabilities that the economy faces to safeguard the nation's bright medium-term prospects for strong growth and job creation. Our goal for the medium-term is to progressively reduce the fiscal deficit to about 3.5 percent of GDP by 2017. This reduction will be driven mainly by improvements in tax policy, revenue administration reforms, and improved management of public funds, expenditure and subsidy rationalization, and the implementation of improved debt management strategies.

10. The macroeconomic targets of the medium-term, based on the macroeconomic framework (2015- 2017) include the following:
    - An average real GDP (including oil) growth rate of at least 6.4 percent.
    - An average non-oil real GDP growth rate of at least 4.2 percent.
    - An inflation target of 8 percent with a band of ±2 percent.
    - An overall Budget Deficit of about 3.5 percent by 2017.
    - Gross International Reserves which will cover not less than 4 months of imports of goods and services by 2017.

11. The specific macroeconomic targets for 2015 are as follows:
    - Non-oil real GDP growth of 2.3 percent.
    - Overall real GDP (including oil) growth of 3.5 percent.
    - An end year inflation target of 12.0 percent.
    - Overall budget deficit equivalent to 7.5 percent of GDP.
    - Gross international reserves of not less than 3 months of import cover of goods and services.

## POLICY MEASURES FOR 2015-17

12. Key to ensuring the Government's commitment to "***a stable, united, inclusive and prosperous country with opportunities for all*** are medium-term policy measures that closely match the MSCGC's development objectives and pillars.

## Pillar 1: Strengthening institutions for more predictable fiscal outcomes.

*Control of the wage bill*

13. Since the wage bill has been one of the sources of fiscal slippages in recent years, Government has since 2013 been implementing measures to control the wage bill and improve payroll management. Some of these measures include:
    - The Electronic Salary Payment Voucher (ESPV) system and the E-Pay Slips system which have been introduced to reduce the incidence of ghost workers on the Government payroll.
    - Periodic payroll audit to streamline the payroll and reduce the incidence of ghost workers.
    - A Human Resource Information Management system (HRMS) system is being developed to address HR management issues in the Public Service and related payroll issues thereby impacting positively on the payroll management.
    - A Cabinet subcommittee has been established to oversee the implementation of payroll measures to improve payroll management in the country.

14. To further rationalize and improve the quality of expenditure, the Government maintains its stance of negotiating public sector wages within budgetary constraints to ensure the sustainability of the Single Spine Pay Policy. Furthermore the Government will ensure full implementation of the ESPV and ensure the payroll system is linked to the HRMIS and other core financial management systems.

    Negotiations for the 2015 minimum wage and base pay have been completed, resulting in a 13 percent increase over the 2013 base pay levels and the end of the 10 percent Cost of Living Allowance (COLA) granted for the 2014 financial year.

*Control of Government subsidies and arrears*

15. The Government recognizes that adequate supply of energy remains a major challenge for us. In 2014, the cost of doing business in Ghana went up because of disruptions in electricity supply. Government recognizes that energy remains an absolutely critical requirement for sustainable economic growth and development. In this regard, the Government will continue to implement the existing price adjustment mechanisms for utility tariffs and fuel prices which are expected to have a positive fiscal impact. As the gas supply situation improves, we expect that consumers will also see the benefits of the utility price adjustments when prices assume a downward trend.

16. To ensure gains on the expenditure side the Government is committed to clearing domestic arrears and strengthening commitment controls to ensure they do not build up in future. The Government has therefore designed and implemented a 'procure to pay' (P2P) policy to track and capture commitments, which will in turn support improved control of arrears.

a. To complement these expenditure reforms the following tax measures which underpin the Government's medium term fiscal objectives are being implemented: Imposition of Special Petroleum Tax of 17.5 percent as part of a rationalization of VAT regime and change in the petroleum pricing structure, estimated to yield GH¢1,490 million (1.1 percent of GDP);

b. Extension to 2017 of the special import levy of 1-2 percent on some imported goods, estimated to yield GH¢521 million (0.4 percent of GDP);

c. Extension to 2017 of the National Fiscal Stabilization Levy of 5% of profit before tax of Banking, insurance, other financial services, communication and brewery sectors, estimated to yield GH¢246 million (0.2 percent of GDP);

d. Implement the VAT on Fee-based financial services and the 5 percent flat rate on real estate. This is estimated to yield GH¢201 million (0.15 percent of GDP);

e. Increase in withholding tax on Director's fees from 10 percent to 20 percent, increase in withholding tax on goods and services from 5 percent to 7.5 percent, and a 50 percent increase in Vehicle Income Tax. All these are estimated to yield GH¢111 million (0.08 percent of GDP). These will be part of the Income Tax Bill that were submitted to Parliament in the first quarter of 2015;

f. In addition to these the corporate income tax for Free Zones and other tax related issues on Free Zones companies will be reviewed. This is estimated to yield revenue of GH¢4.0 million.

The implementation of the revenue measures outlined above is estimated to yield a total amount of GH¢2,573.3 million or about 2 percent of GDP in 2015.

*Enhanced debt management*

17. Ghana's public debt stock as a percentage of GDP has been rising rapidly over the years. It increased from 36.3 percent in 2009 to 48.0 percent in 2012 and further to 55.5 percent in 2013. As at end December 2014 the debt stock stood at 65 percent, largely on account of increase in external net disbursements for infrastructure projects and net domestic issuance, and the depreciation of the Cedi.

18. The Government's new debt management strategy will, over the medium-term continue to focus on providing a more cost-effective access to the international and domestic capital markets. In 2014, Government tapped the Eurobond market to obtain long-term funds for debt restructuring, counterpart funding and financing of capital expenditure. This is in line with the objective of diversifying sources of funding, extending the tenor of public debt and reducing the overall cost of borrowing. In 2015 government intends to use short-term borrowings for liquidity management purposes and shift towards long term borrowing for capital expenditure and debt management, including reduction of liquidity and refinancing

risk In this regard, in 2015 the Government plans to issue a Eurobond supported by the World Bank's Policy Based Guarantee whose proceeds would be used to refinance its existing external and domestic debt

**Pillar 2: Enhancing the productivity of public spending**

19. To make public expenditure more efficient and effective the Government remains committed to ongoing reforms in Public Financial Management (PFM). To facilitate a holistic approach to implementation of our PFM reforms, a new PFM strategy has been developed. In the meantime our current flagship programme, the Ghana Integrated Financial Management System, (GIFMIS) is ongoing. To sustain its implementation we have started to negotiate GIFMIS II financing with the World Bank and other DPs.

20. The key components and goals of the PFM strategy include increasing efficiency in processing budget and financial accounting transactions; improvements in payroll management; establishment of a HRMIS; improved domestic revenue mobilization under the GRA reforms; and a comprehensive review of all the revenue and expenditure laws.

*Improved SOE governance*

21. The Government is committed to applying its fiscal responsibility principles to all public sector agents, including sub-vented agencies, state owned enterprises (SOEs), and local governments. All of them are sources of claims to the budget, in particular SOEs, due to the existence of implicit or explicit guarantees. A comprehensive management of fiscal risk is necessary due to the need to deliver public services in association with the private sector. This is due to the scarcity of public funds and to the recognition that the private sector can do certain activities more efficiently than the public sector.

22. SOEs in Ghana are confronted with many challenges. As at the end of December 2012, there were about 26 fully owned SOEs listed by the State Enterprises Commission (SEC) operating in critical sectors including energy, finance, and infrastructure sectors. As a group, SOEs in Ghana have a total asset base ranging from GH¢4.3 billion (approximately US$2.2 billion) to GH¢24.4 million (approximately US$12.7 million).

23. Efforts are need to improve regulation of the SOEs and in particular external scrutiny. A comprehensive assessment of performance of the major SOEs and public service regulators, including governance review of statutory independence and accountability, is an important aspect of the economic reform program. This assessment will include a review of operations and finances, the legal and governance framework, and the institutional environment of SOEs. The major SOEs earmarked include the Electricity Company of Ghana (ECG), Volta River Authority (VRA), Ghana National Petroleum Company (GNPC) and Ghana Water Company Limited (GWCL). The main regulators concerned include Bank of Ghana (BoG), National Pensions Regulatory Authority (NPRA), Social Security and National

Insurance Trust (SSNIT), and State Enterprise Commission (SEC). Government will ensure that consistent action plans are derived from the performance and governance reviews for implementation.

24. The Government remains committed to transparency and good governance in the management of the oil and gas sector. Accordingly efforts are underway to improve the quality and make public the audited public financial statements and annual reports of the Ghana National Petroleum Company (GNPC).

*Improved public investment management*

25. The Government will continue to strengthen its public investment management (PIM) system, guided by the recently issued national PIM Policy and forthcoming guidelines for the PIM system. With public investment expected to grow rapidly there is a need to revise the guidelines for budget preparation, make operational the PIM System (an ICT management tool and database of public investment projects and set-up a robust monitoring and evaluation system.

26. The Government will also make operational the Ghana Infrastructure Investment Fund (GIIF) established by law in 2014. The Fund will be used to mobilize, manage, coordinate and provide financial resources for investment in a diversified portfolio of infrastructure projects for national development. The GIIF is to begin effective operations in 2015 after the announcement Board and Advisory Council Members. In the interim government will transfer key projects on government balance sheet that meet the GIIF primary commercial loans criteria to the Fund to manage. These projects include the Bui Dam, and the Gas processing Plant and Pipelines.

27. Furthermore, funding requirements for self-financing projects being undertaken with government guaranteed loans will be passed to GIIF. In addition, counterpart funding for some selected commercial projects will be provided from the Fund. Projects and loans associated with Special Purpose Vehicle (SPVs), Joint Ventures and PPP projects will also qualify for funding under GIIF. Most of the projects to be covered by GIIF will be in the energy, road and transport sectors.

*Protecting the poor during the transition*

28. The Government continues to implement measures to strengthen existing social protection mechanisms. To implement the policies and programmes in the National Social Protection Strategy, the Livelihood Empowerment Against Poverty (LEAP) is central to the government's approach. The LEAP will be scaled up and a common targeting mechanism developed to ensure efficiency and complementarities between the LEAP and other social protection programmes.

**CONCLUSION**

29. The Government of Ghana has been taking appropriate measures to pursue the country's development agenda. We believe that with continued support from the World Bank Group and other development partners, Ghana will be able to achieve the objectives set out in the GSGDA II to provide ***"a stable, united, inclusive and prosperous country with opportunities for all".***

We therefore continue to count on your support to help meet the aspirations of our people.

Yours sincerely,

**HON. SETH E. TERKPER**
**MINISTER OF FINANCE**