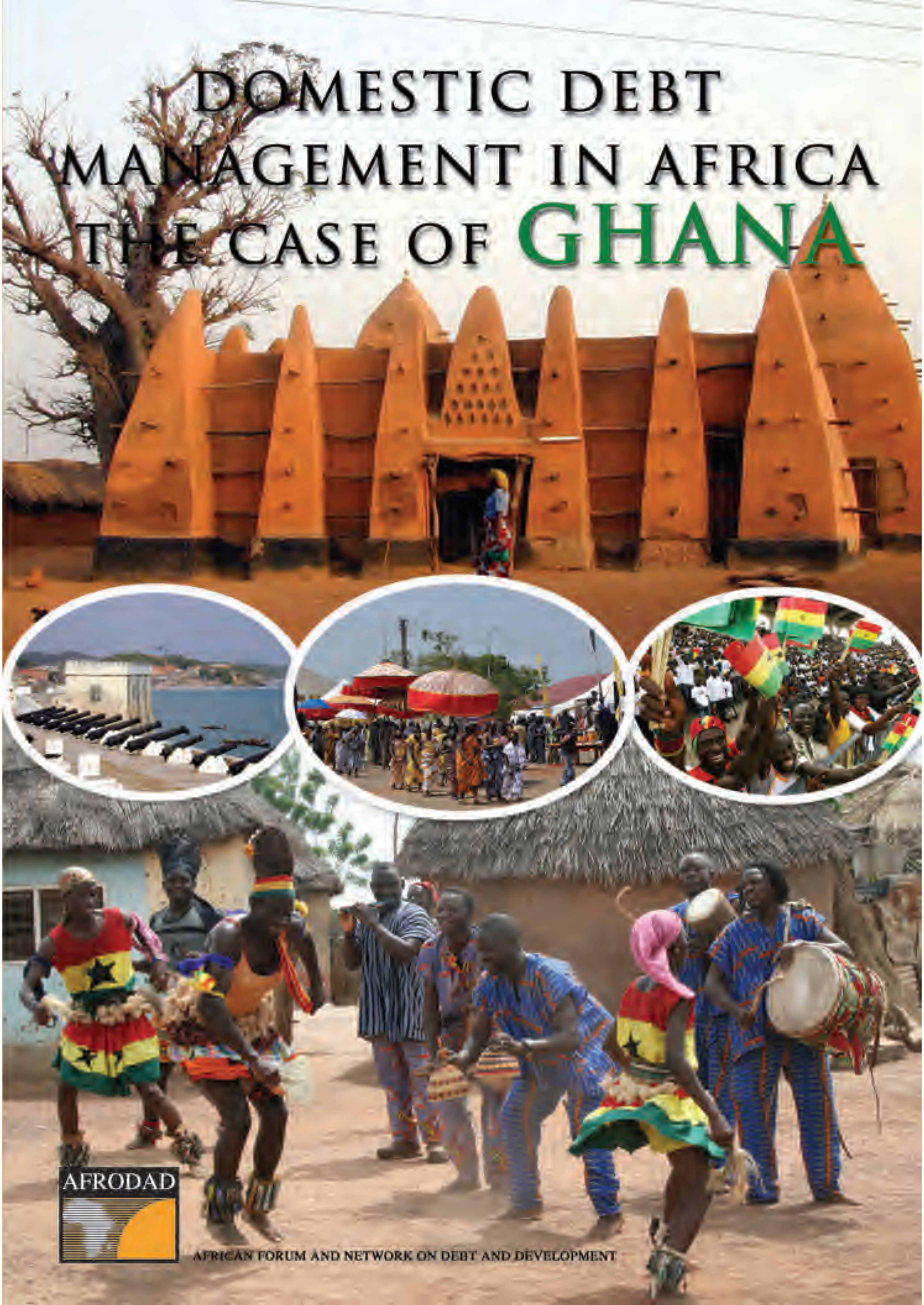
DOMESTIC DEBT MANAGEMENT IN AFRICA THE CASE OF GHANA



AFRODAD

AFRICAN FORUM AND NETWORK ON DEBT AND DEVELOPMENT

About AFRODAD

Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

Objectives include the following:

1 To enhance efficient and effective management and use of resources by African governments;
2 To secure a paradigm shift in the international socio-economic and political world order leading to a development process that addresses the needs and aspirations of the majority of people in the world;
3 To facilitate dialogue between civil society and governments on issues related to Debt and Development in Africa and globally.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being apolitical, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level to protect the interests of the weaker nations. The transparent arbitration mechanism on debt proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

AFRODAD aspires for an African and global society that is just (equal access to and fair distribution of resources), respects human rights and promotes popular participation as a fundamental right of citizens (Arusha Declaration of 1980). In this light, African society should have the space in the global development arena to generate its own solutions, uphold good values that ensure that its development process is owned and driven by its people and not dominated by markets/profits and international financial institutions.

AFRODAD is governed by a Board composed of seven members from the five regions of Africa, namely east, central, western, south and the North. The Board meets twice a year. The Secretariat, based in Harare, Zimbabwe, has a staff compliment of seven programme and five support staff.

Domestic Debt Management in Africa

The Case of Ghana

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Acronyms

AC	Auction Committee
ADMD	Aid and Debt Management Division
BOG	Bank of Ghana
CAGD	Controller and Accountant General Department
CDD	Centre for Democratic Development
CEPA	Centre for Economic Policy Analysis
CEPS	Customs Excise and Preventive Service
CGD	Centre for Global Development
CMDSF	Commonwealth Ministerial Debt Sustainability Forum
CPI	Consumer Price Index
CSD	Central Security Depository
CSDRMS	Commonwealth Secretariat Debt Recording and Management System
CSO	Civil Society Organisation
DACF	District Assemblies' Common Fund
DSA	Debt Sustainability Analysis
ECOMOG	ECOWAS Monitoring Group
E-HIPC	Enhanced Highly Indebted Poor Country
ERP	Economic Recovery Program
FAA	Financial Administration Act
FINSAP	Financial sector Adjustment Programme
FRL	Fiscal Responsibility Law
GCAA	Ghana Civil Aviation Authority
GCB	Ghana Commercial Bank
GDP	Gross Domestic Product
GES	Ghana Education Service
GETFund	Ghana Education Trust Fund
GGILB	Government of Ghana Index Link Bond

GPRSII	Ghana Poverty Reduction Strategy
GRA	Ghana Revenue Agency
GRB	Gender Responsive Budgeting
GUSS	Ghana Universal Salary Structure
HIPC	Heavily Indebted poor Country
IDA	International Development Assistance
IDEG	Institute for Democratic Government
IEA	Institute of Economic Affairs
IGF	Internally Generated Fund
IMF	International Monetary Fund
IRS	Internal Revenue Service
ISODEC	Integrated Social Development Centre
MDA	Ministries Development and Agency
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MoFEP	Ministry of Finance and Economic Planning
NDC	National Democratic Congress
NDF	Net Domestic Finance
NRC	National Redemption Council
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
PSBR	Public Sector Borrowing Requirements
RAGB	Revenue Agencies Governing Board
SAP	Structural Adjustment Programme
SSSS	Single Spine Salary Structure
TMC	Treasury Management
TOR	Tema Oil Refinery
UNDP	United Nations Development Programme
VATS	Value Added Tax Service
VRA	Volta River Authority
WEO	World Economic Outlook

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Preface

Domestic public debt is not a new phenomenon for developing countries. In the face of budget deficits, against a backdrop of drying up of concessional lending and reduction in development assistance due to the impact of the global financial crisis among others, borrowing from domestic markets becomes a viable option. However far less attention has been given to domestic debt in most development policy discussions carried out. The efforts over the years have been centered on external debt where much focus has been on the HIPC and MDRI initiatives. While there has been a remarkable policy shift on external debt following implementation of HIPC and MDRI in a few developing countries, AFRODAD has seen the emergence of a new threat in debt management due to domestic borrowing which is not under the same scrutiny as external borrowing.

Domestic debt has been used to finance primary deficits and implement monetary policies in most African governments, such that in some countries domestic debt now constitutes a large share of the total debt stock. AFRODAD believes that reforms in debt management are critical to avert a vicious cycle of recurring debt burden. If domestic debt is not kept sustainable it will erode the benefits accrued from initiatives like HIPC and MRDI which had improved the fiscal space by freeing resources on the trajectories of pro-poor development policies in most HIPC countries. Domestic debt can be beneficial if used for the right purposes; however, enormous levels of domestic debt may have a negative effect on financial stability. Arguments against domestic debt include the crowding out effect on private investment and its subsequent effect on economic growth especially in countries with relatively narrow domestic markets. Domestic debts also affect the level of interest rates as they making borrowing expensive due to the relatively narrow investor base and the monopolistic tendencies of most investor groups in Africa.

Furthermore, domestic debt service absorbs a significant amount of government resources which could be used for social services and other pro poor expenditures in the economy. The Ghana study reiterates the fact that the financial market should continue to be developed so that it improves its capacity to absorb new debt in order to keep the levels of interest's rates low. The study found that in Ghana there are clear procedures and legislations for issuing and management of domestic debt. However, it boggles the mind that the period under review demonstrated lack of adherence to legislations governing debt management with instances where no supplementary budgets were submitted yet government expenditure was more than the budgeted amount for that particular financial year.

This report analyses the development in public domestic debt in Ghana, and its impact on the economy for the period 2000 to 2009 with the objective of looking at the institutional framework regarding the budgetary process, uses of public funds and contracting of loans and making policy recommendations for improving the management of the debt. The study takes a critical look at the legal framework, structure of the domestic debt, its impact on the economy, the sustainability of the debt and the extent to which the discovery of oil and gas will impact on internal revenue generation leading to reduction in budget deficits. It also provides an assessment of the nature of the relationships between different policy instruments for domestic debt acquisition and the role of different stake holders in domestic debt management such as parliament, civil society and international financial institutions. Actionable policy recommendations in improving aspects of domestic debt management conclude the report. This also raises a number of concerns to be addressed if Ghana is to continue on its path of prudent public debt management. AFRODAD hopes that the Ghanaian government will take the findings of this report seriously and address the concerns aptly.

Collins Magalasi
Executive Director
AFRODAD

Section 1: Introduction

1.1 Historical Background

In March 1957 at independence the British left behind substantial foreign reserves as well as physical and social infrastructure. The Nkrumah government further developed the infrastructure and made important public investments in the industrial sector. These investments were to pave way for accelerated economic growth. However, most of these projects were badly managed. With cocoa prices falling and the country's foreign exchange reserves fast disappearing, the government resorted to supplier credits to finance many of the projects. By the mid-1960s, Ghana's reserves were gone, and the country could not meet repayment schedules. Since then, Ghana has been caught in a cycle of debt. Between 1966 and 1969, on three occasions, Ghana's creditors agreed to reschedule repayments due on Nkrumah-era supplier credits. Led by the United States, foreign donors provided import loans to enable the foreign exchange-strapped government to import essential commodities.

Despite considerable foreign assistance and some debt relief, the Busia regime (1969-1972) also was unable to overcome the inherited restraints on growth posed by the debt burden, balance-of-payments imbalances, foreign exchange shortages, and mismanagement. The National Redemption Council (NRC) government (1972-78), which had inherited foreign debts of almost $1 billion, abrogated existing rescheduling arrangements for some debts and rejected other repayments. After creditors objected to this unilateral action, a 1974 agreement rescheduled the medium-term debt on liberal terms.

In the 1970s, the deficit was mostly financed by the printing of money leading to strong inflationary pressures. This mode of financing was forced on the economy by the financial environment of the time. The financial system, particularly the money market, was underdeveloped and Treasury bill was not a popular financial instrument; thus the Government could not borrow from domestic sources to support the budget. On the other hand, foreign borrowing was also limited, as the international financial community had blacklisted the country following repudiation of some external debts by the Government of the NRC. Hence, the resort to the printing of money to finance the deficit, causing inflation to spiral upwards, hitting 123 percent in 1983 and that same year the government launched the Economic Recovery Program (ERP) under the guidance of the World Bank and the IMF. The overriding purpose of the ERP was to reduce Ghana's debts and to improve its trading position in the global economy. The stated objectives of the program focused on restoring economic productivity at minimum cost to the government and included the following policies: lowering inflation through stringent fiscal, monetary, and trade policies; increasing the flow of foreign exchange into Ghana and directing it to priority sectors; restructuring the country's economic institutions; restoring production incentives; rehabilitating infrastructure to enhance conditions for the production and export of goods; and, finally, increasing the availability of essential consumer goods.ERP policies during the 1980s resulted in increased external debts as well as in relatively high inflation rates. Most ERP projects were funded by foreign loans, notably from the IMF.

The falling prices of Ghana's two main exports, gold and cocoa, and rising prices of crude oil led to a sharp depreciation of the

Cedi[1] against the major trading currencies and subsequently raised the value of external obligations, resulting in a build-up of both domestic and external debt. The external debt stock at the end of 2000 was 575 percent of revenue in present value terms and this far exceeded the internationally accepted limit of 250 percent for sustainability.[2] The public debt to GDP ratio stood at about 181 per cent of GDP with domestic debt component of 28.9 per cent of GDP. Public debt servicing accounted for 32 per cent and 39 per cent of total government expenditure in 1999 and 2000 respectively.

In view of the above developments, Ghana opted for the Enhanced Highly Indebted Poor Country Initiative (E-HIPC) in 2001, aimed at reducing external debt and releasing resources to pursue poverty-reducing programmes. The HIPC Initiative was launched to reduce the external debt burden of all eligible HIPCs to sustainable levels in a reasonably short period of time because debt is an obstacle to sustainable economic growth and poverty reduction. While the original goal of the initiative was to reduce high external debt as a constraint to economic growth and poverty reduction, the Enhanced initiative aimed to provide a viable exit from debt rescheduling, to promote growth, and to free up financial resources for more social spending to reduce poverty. After having completed the HIPC initiative the external debt stocks and debt service of most HIPCs should be below those of most poor countries. Similarly, debt sustainability is one important indicator for the achievement of the Millennium Development Goals (MDGs). One measure used to achieve debt sustainability was using the HIPC initiative.

1 *Cedi is the unit of currency in Ghana*

2 *Bank of Ghana Annual Report 2001*

In 2004, public debt dropped to US$8.35 billion from US$9.09 billion in 2003 as a result of debt cancellation at the Completion Point of the HIPC Initiative. The public debt reduced further to US$5.31 billion in 2006 due to the Multilateral Debt Relief Initiative (MDRI) which resulted in a cancellation of about US$4.2 billion debt owed to multilateral institutions.

Although the focus to date has been very much on low income countries external debt sustainability, there is a pressing need to analyse domestic and total public debt sustainability in relation to the budget (also referred to as fiscal sustainability), particularly because domestic debt issuance for fiscal financing and monetary policy implementation has been growing in many low-income countries in recent years. The IMF estimated that domestic debt accounts for about 20 per cent of total public debt in the typical low-income country in 2006[3].

Ghana's domestic debt is a problem of the 1990s. Prior to this period, domestic financing of the fiscal deficit was mostly done by printing of money. Gross domestic bonded debt rose sharply from 3 percent of GDP in 1990 to about 25 percent of GDP at the close of the millennium. The evolution of the domestic debt was through fiscal excesses beginning from 1990. Unbudgeted outlays for hosting of the Non-Aligned Movement's Ministerial Conference and the peacekeeping operations in Liberia (ECOMOG) in 1990, and later expenditures on district level elections proved to be too much strain on the fragile economy and the country has not recovered since. In the case of the district level elections, as in all other political expenditures, there were budgeted costs related to the process and unbudgeted costs to influence the process. The

3 IMF (2006), page 28

fiscal pressures of these unplanned expenditures were exacerbated by the fact that the availability of program aid was very limited in the 1990s and disbursement of project aid had slowed down considerably — not unrelated to the policy failures.

There was no evidence to support any crowding out of credit to the private sector due to increase in the holdings of the domestic debt by the commercial banks. During the study period, as total debt held by the banks increase, credit to the private sector even increased faster. Cost of borrowing, however, increased as the lending rates were about 10 percentage points higher than the Treasury Bill rates.

1.2 Review of Literature

According to Simpson (2006), debt-servicing problems in developing countries are likely to arise when official creditors, such as international organizations or governments, and donors do not provide sufficient new financing in terms of loans or grants for financing a country's primary deficit[4], or when the costs of servicing domestic debt become very high. A study conducted by the IDA in 2004 showed that, although external official debt is the dominant source of financing, domestic debt is far from negligible in some developing countries[5].

For most HIPC countries, the phrase "domestic debt" is usually an expression for debt instruments issued by the central government (Johnson, 2001). In principle, regional and local governments can

4 *Information regarding which factors determine the allocation of resources from official creditors to low-income countries can be found in Birdsall et all. (2002) and Powell (2003).*

5 *A recent study showed that 6 out of 20 low-income countries had a ratio of domestic debt to GDP greater than 25 percent. See IDA "Debt Sustainability in Low-Income Countries: Proposal for an Operational Framework and Policy Implications", February 2004, IDA SECM2004-0035.*

also issue debt, as can public enterprises, and, together with central government debt, make up 'public domestic debt'.

In general, there are three main reasons for government domestic debt, according to Johnson (2001). The first is for budget deficit financing. If the government is unable to meet its expenditure commitments from domestically raised revenue, such as taxes and duties, and externally sourced grants and borrowings, then it may seek to borrow domestically.

The second is implementing monetary policy. The government can implement monetary policy by altering the supply of money in the economy. It does this by buying or selling treasury bills, that is, by open market operations. Government sales of treasury bills reduce the money supply and mop up liquidity as people and institutions buy treasury bills and hence hold less money; whereas government purchases of treasury bills pump money into the economy as people sell treasury bills and hold more cash.

For most developing countries domestic debt is comprised of government issued instruments, both short-term, medium-term and long-term, for fiscal financing and monetary policy implementation. These instruments are comprised of Treasury Bills, bonds and all types of stocks. In addition domestic debt can include central bank issued instruments for monetary policy implementation, as well as central bank holdings of other long-term government liabilities, such as undated stocks or interest-free instruments arising from the conversion of government overdraft facilities or recapitalization. It can also include government payment arrears to civil servants, suppliers and others and contingent liabilities.

In his study, Christensen (2005) observed that interest rates on domestic debt are generally very high in sub-Saharan African countries and maturities tend to be short, exposing a country to significant roll-over risks. Unlike external debt, domestic debt is usually issued at market rates. This implies that costs of servicing domestic debt do depend on the macro-economic environment and are therefore volatile. The consequences of huge domestic are that, first, a sizable portion of government revenue will be channeled to servicing the debt; and second, the likely increase in interest rates that will lead to high cost of borrowing by the private sector which will crowd-out private sector investment.

Some argue that, the high debt burdens suffered by many developing countries that have seen their debts written down over recent years were not the consequence of high levels of borrowing. This has been convincingly argued by Todd Moss in a paper produced for The Centre for Global Development (CGD). In his view, the high debt burdens have resulted from poor economic growth.

Heavy debt burdens and poor economic performance are certainly linked. In Simpson's (2006) study on debt and development in Ghana, he established that while the rise in absolute debt levels between 1970 and 1990 is matched in parallel by increase in the debt burden, this pattern is not evident between 1994 and 2005. The absolute debt burden increased from US$5 billion to US$7 billion. The debt burden fell by 18 per cent due to improved economic growth.

The level of debt stock of a country is the amounts owed to creditors that are guaranteed by the government of the country. This is an absolute amount which tells us little about the economic situation. The level of debt burden, in contrast, is a relationship of factors. The debt burden which a country suffers is the function not just of the level of debt, but also of the level of economic activity of a country. The level of debt burden of a country is also a relationship over time. Comparing debt stock to gross domestic product is not sufficient. The rate of change of these two variables is an important factor to consider. Debt that finances productivity is different in kind than that use to finance recurrent expenditure. With all the policy initiatives put in place to foster fiscal sustainability, Ghana's debt sustainability has been in danger even after the HIPC Initiative. Interest payments on domestic debt remains high, averaging 75 per cent of interest payments of total public debt. The debt indicators improved annually from 2000 till 2006, when it started deteriorating. The country never met the interest-to-revenue ratio criteria for debt sustainability (4.6 – 6.8) set by Debt Relief International[6] throughout the period under review.

The IMF describes the domestic debt burden as significant when the ratio of nominal domestic debt stock to GDP ratio is above 15% - 20% and it recommends that IMF staff thoroughly review the risks in such cases when doing debt sustainability analyses in low-income countries. Considering this threshold, Ghana's domestic debt is unsustainable. It is evident that, Ghana risks doubling its public debt-to-GDP ratio over two decades if the 2009 level of the primary deficit is not reduced.

6 *Debt Relief International (DRI) is part of the Development Finance Group based in London, is a non-profit organisation established in July 1997. It is one of the HIPC Capacity Building Programme implementing partners and, as Technical Office of the CBP, has managed the programme on behalf of the CBP donors*

Section 2: Legal Framework and Institutional Arrangement

This section deals with the structures put in place to foster fiscal sustainability. Laws and regulations governing the raising and disbursement of public funds are scrutinized for their operational efficiency and compliance. Transparency in financial reporting and inconsistencies in financial data is also discussed.

2.1 Legal framework

Articles 174 to 182 of the 1992 Constitution of Ghana unpack the constitutional provisions regarding public revenues and expenditures. The public funds of Ghana, according to Article 175, "shall be the Consolidated Fund, the Contingency Fund and such other funds as may be established by or under the authority of an Act of Parliament." Articles 176 and 177 defines the composition of the Consolidated Fund and Contingency Fund respectively, while Article 178 talks on the withdrawal from public funds, Article 179 on authorization of expenditure, Article 181 on loans, and Article 182 on public debt. There is also a Public Accounts Committee, one of the standing orders in parliament, whose duty is to examine the public accounts showing the appropriation of the sums granted by parliament to meet public expenditure and such other accounts laid before it together with auditor-general's reports on the accounts.

Though the provisions on finance in the constitution give clear rules and regulations on the use of public funds, it is silent on the limits to which the state could spend. Article 179 clause 8 for instance, allows the minister of finance to present a supplementary budget to parliament for its approval, if it is found the amount of moneys appropriated by the Appropriation Act for any purpose is insufficient or that a need has arisen for expenditure for a purpose for which no amount of moneys has been appropriated by that Act. The practice is that the majority in parliament who are members of the ruling government always vote for approval of appropriation of funds if even the minority has genuine and strong reason for voting otherwise. This action does not contravene Article 181 (1) of the 1992 Constitution, but the partisan nature of the use of this Article is what is worrying.

Meanwhile, The Bank of Ghana (BOG) Act, 2002 (Act 612) gives a limit on the amount of temporary advances that can be made available to the government. This is found in section 30 (2) of the Act, which states that "The total of the loans, advances, purchase of treasury bills and securities together with money borrowed by the Government from other banking institutions and the public at the close of a financial year under subsection (1) **shall not exceed 10 percent of the total revenue of the fiscal year in which the advances were made".** However, Section 30 (6) permits the Minister of Finance, in case of emergency, to meet the Governor and Accountant-General to decide on the limit of borrowing that should be made by Government.

Although, fiscal policy has remained committed to the stabilisation process, the trends after 2006 point to the need to further consolidation ensuring long-term fiscal sustainability. Monetary policy formulation, underpinned by the BOG Act (Act 612), has been transparent and focused on effective monetary management and the establishment of a sound financial sector. Within this context, through a policy brief by BOG in January 2008, it was made known to the public that government has proposed a legislation of a Fiscal Responsibility Law (FRL) to strengthen its commitment to fiscal discipline and debt sustainability. This raises a fundamental question as to whether such an Act will promote fiscal discipline similar to how BOG Act 612 has strengthened the formulation of credible and transparent monetary policies. The proposed law has not been passed by parliament yet.

The country can control fiscal slippages better if fiscal rules and laws are enacted. By definition, fiscal rules are statutory or constitutional restrictions that set specific limits on fiscal indicators such as budgetary balance, debt, government spending, or taxation (Kennedy and Robbins, 2001). Primarily, fiscal rules seek to disengage fiscal policy from government influence much like the separation of monetary policy embodied in inflation-targeting frameworks. They also impose greater accountability on government finances, drive expectations and enhance transparency of the overall budgetary framework. Again, as noted by Brunila (2002), such rules help tackle a country's predisposition to budget deficits by pre-empting possible spending overruns and thereby help to address the political and institutional tendencies to raise expenditures during economic booms.

2.2 Debt Management Strategy

Domestic debt management policies are geared towards the deepening of the money market, maintain the domestic debt at sustainable levels, realign the maturity profile and diversify the investor base. Debt management has been largely successful but with lots of challenges as the short-term bills re-emerged as the largest subscribed instrument in 2009.

The aid and Debt management division of the ministry of finance and economic planning (MOFEP) is the closest thing to a national domestic debt management strategy. This division "owed its origin in the External Debt Secretariat (EDS) set up in the 1970s by Legislative Instrument (LI) 57, and located outside the Ministry devoid of the Minister's control and supervision. The Aid component was then managed by the International Economic Relations (now External Resource Mobilisation) of MOFEP. EDS was brought to MOFEP in the late 1980s during the Structural Adjustment and Economic Reform era and named Debt Management Unit (DMU)".

The Unit's terms of reference then was to advise government on prudent external aid and debt management policies and strategies and manage the external debt. As the focus of debt management worldwide shifted towards public debt, it becomes imperative that the Unit takes up the challenge of also managing the domestic debt from the fiscal policy management in collaboration with the Bank of Ghana. DMU was later streamlined with the aid management ceded to it and named Aid and Debt Management Unit (ADMU) under External Resource Mobilisation Division (Bilateral and Multilateral). By the early 2000, the Unit was managing the total debt portfolio of government. With the venture into the international capital market to raise funds for key priority sectors of the economy in 2007, the Unit was assigned additional task of providing technical support to the Capital Market Committee (CMC) and administering bond proceeds thereafter until maturity. In the light of the widening scope of Unit's operations and strategic role, it was upgraded into a Division in 2004. Currently, the Division operates directly under the supervision of the Deputy Minister in charge of Finance".

The practice now is that, domestic debt management strategies are outlined in each annual budget statement. The highlights of the strategies are how to maintain the debt stock at sustainable levels, realignment of maturity profiles and diversification of investor base. The strategy for each budget is mainly decided by the level, maturity structure, and investor composition of government's debt instruments of the previous year and the fiscal deficit for the current year.

The country has debt management objectives is to minimize the financial cost of the public debt while maintaining the market and operational risks at an acceptable level, taking into account the general objectives of the fiscal and monetary policies. To achieve this, the Debt and Aid management Division is challenged to pursue rigorously the following six (6) broad objectives[7]:

- Resource mobilization through raising adequate levels of funding to meet government's financing needs at a minimum cost and prudent level of risk.

- Pursue prudent debt management strategies and policies to maintain public debt sustainability.

- Research and analysis by developing and strengthening research as a continuous tool to explore contemporary innovations in raising funds and to facilitate analysis and design of appropriate debt management policies and strategies.

7 *Ministry of Finance and economic planning: http://www.mofep.gov.gh/admd_objective.htm*

- Operational frameworks with a mandate to develop relevant systems, procedures and controls to improve operational efficiency and minimize risk within a framework of comprehensive business continuity plan

- Staff development aiming at attracting, maintaining and promoting the needed skill mix of professionals within a comprehensive and systematic capacity development programme to confront the challenges in aid and debt management

2.3 Enactment and amendments of bills

Over the period under consideration, progress was made in institutional arrangements and the regulatory environment to ensure better fiscal management. These include the Medium-Term Expenditure Framework, and enactment of Financial Administration, Internal Audit and Procurement Acts. The Financial Administration Act, 2003 (Act 654) regulates financial management of the public sector, prescribes the responsibilities of persons entrusted with financial management in the government and seeks to ensure the effective and efficient management of revenue, expenditure, assets, liabilities and the resources of government. The Internal Audit Agency Act, 2003 (Act 658) established an Internal Audit Agency as a central agency to co-ordinate, facilitate, monitor and supervise internal audit activities within Ministries, Departments, Agencies, Metropolitan, Municipal and District Assemblies in order to secure quality assurance of internal audit within these institutions of State; to provide for the Board of the Internal Audit Agency.

The Public Procurement Act, 2003 (Act 663) was enacted as an Act of Parliament to provide for public procurement; establish the Public Procurement Board; make administrative and institutional arrangements for procurement; stipulate tendering procedures and to provide for the purposes connected with these functions. The Act harmonises the application of procurement related rules with international conventions and treaties. It is expected to foster competition, efficiency, transparency and accountability in the public procurement process.

One of the most important aspects of fiscal policy is how to manage the tax environment, especially tax laws and tax information so that households and businesses can make their consumption, savings and investment decisions in the most efficient way possible. A Revenue Agencies Governing Board (RAGB) was established to be the central governing body replacing governing boards of the respective national revenue agencies existing previously, that is, the Internal Revenue Service (IRS), the Value Added Tax Service (VATS) and the Customs, Excise and Preventive Service (CEPS). In 2009, the RAGB was changed to the Ghana Revenue Agency (GRA) under the Ghana Revenue Authority Act, 2009, (Act 791). Reforms were made to correct the identified shortcoming and organizational weaknesses inherent in the country's tax system. A few provisions inhibiting effective collection of taxes and also correcting certain errors and omissions were tabled in the Internal Revenue (Amendment) Bill, 2002 and Internal Revenue (Amendment) Regulations 2002. The Amendments include carry-over losses; foreign exchange gains and losses; withholding tax on rent; accumulated capital allowances; and vehicle income tax. The charges and rates for stamp duty under the stamp Duty Act 1965 (Act 311) was also revised with the coming into force of Stamp Duty Act 2005 (Act 689).

In order to strengthen the operations of the IRS, logistics were provided to enable the Service deepen the tax coverage, particularly in urban centres so as to rope in landlords, artisans and traders some of whom have not been paying taxes on incomes as required by Law. Efforts were also made to rope into the tax net, private consultants and persons in professional practice such as lawyers, architects and engineers, some of whom have hitherto not been paying taxes on their income. In this regard, Ministries, Departments, and Agencies (MDAs) were requested to obtain Tax clearance certificate before awarding contracts to any professional or consultant. MDAs are also required to submit a list of all contracts awarded to consultants to the IRS and the Ministry of Finance.

As part of measures aimed at widening the tax base, a VAT law was passed to reduce the threshold from GH¢ 20,000 to GH¢ 10,000[8] for retailers of goods except retailers of pharmaceutical products which were exempted. Administrative measures were also undertaken by CEPS to improve revenue collection. Key among these reforms is the full automation of customs procedures and Trade Agreement on Transit Trade with Togo, Burkina Faso and Cote d'Ivoire to ensure exchange of information so as to eliminate revenue leakages.

2.4 Transparency and efficiency in institutional frameworks

Article 21 (1)(f) of the 1992 Constitution states that "All persons shall have the right to information, subject to such qualifications and laws as are necessary in a democratic society." By way of

8 1US$=1,4334 GH¢ on 88/27/2008

transparency, according to PEFA assessment, Ghana does very well with respect to public access to budgetary and financial documentation; however with respect to inter-governmental fiscal transfers it does poorly. Audited financial reports are submitted for public enterprises however with respect to the consolidation of fiscal risk, the oversight of public enterprises and public borrowings are areas where weaknesses remain.

Two factors that can undermine the credibility of the budget are significant extra budgetary activities, and the poor monitoring of fiscal risk, debt and contingent liabilities. The Public Finance Management (PFM) systems accommodate for well controlled virement procedures with well documented and suitably controlled procedures for in-year adjustments to budget allocations above the level of management of MDAs through a well controlled use of supplementary budgets with parliamentary oversight. The credibility of the original budget allocations is maintained by specifying in advance an adjustment mechanism in a systematic and fairly transparent manner. However, in 2008 (an election year) the supplementary budget process was ignored; this in spite of massive expenditure over approved budget ceilings.

Closely related has been the lack of budgetary discipline applied to domestic debt. The Loans Act, 1970 requires all loans to be approved by Parliament. It however accommodates a mechanism to be applied to such short term instruments as Treasury Bills whereby the executive does not require approval on each loan by Parliament; provided it remains within approved budgetary ceilings and unchanging terms. Again this is an area where actual levels of domestic borrowings far surpassed parliamentary approved ceilings. Ignoring these legal and regulatory oversight and control procedures undermines budget credibility.

The macro-fiscal framework is developed on a three-year rolling basis, does not yet serve as an effective instrument of budgetary top-down discipline. First, reliable expenditure estimates remain elusive as a consequence of the challenges of predicting the wage bill given the timing of labour union negotiations; predicting the energy subsidies (payments to Volta River Authority (VRA)) and the oil import subsidies (payments to Tema Oil Refinery (TOR)). Second, the actual outturns of net domestic borrowings have not been in keeping with the GPRSII or the approved annual budget estimates. Given that the macro-fiscal estimates are anchored on domestic debt forecasts, such large deviations of actual outturns of domestic debt net borrowings undermine the reliability of the three - year forecasts of the budget estimates.

Actual primary expenditure compared with programmed expenditure shows significant deviations at both the aggregate level and at the level of individual MDAs. The largely ineffective establishment control and commitment controls, complicated further by unpredictable budget releases, and not fully disseminated budget ceilings down to the level of budget management ceilings, undermine efforts to maintain expenditure within budget ceilings. It should be noted that both the establishment and commitment controls are premised upon a series of authorizations and visas. But this is distinct from having achieved effective control. The primary expenditure includes a number of statutory funds, which implicit in their design requires a non-discretionary interpretation of the executive's legal obligation to fully fund in accordance with the transfer levels set in the Appropriations Act. In practice, this requirement was not adhered to for the period of review.

Investment expenditure is completely centralised and all payments are made directly by the Ministry of Finance and Economic

Planning (MoFEP). This arrangement should provide an opportunity for implementing an effective commitment control system. It should also facilitate monitoring and accurately reporting on accrued expenditure arrears. In practice, this is not the case. The Auditor General's Report for 2007 finds that the MoFEP grossly understates the level of both accrued roads and non-roads arrears. A comparison of the Auditor General's Report with data provided to the PEFA team directly by the Ministry of Transport shows that the Audit Report also understated.

Again, on financial reporting, the Controller and Accountant General's Department (CAGD) has adopted a rather narrow definition of Articles 40 and 41 of the Financial Administration Act, 2003 (FAA) with respect to financial reporting on the Consolidated Fund activities rather than on a broad definition of the central government's funds. This interpretation has led to an omission of expenditure reporting on retained Internally Generated Funds (IGF) in consolidated financial reports. It has also led to an omission of reporting on Development Partner funded investment expenditure.[9] It appears to have also contributed to financial reporting that is not completely consistent with the budget documentation definitions. This financial reporting approach has given rise to apparent discrepancies between the budget figures which sometimes state gross amounts, and the CAGD's financial reports, which state net figures offset by components not deemed to be a strict constituent of the Consolidated Fund.

In 2008 expenditure substantially exceeded approved budget estimates and borrowings were far in excess of the approved budget even though no supplementary budget was submitted. For

9 *PEFA assessment*

a number of years the domestic borrowing limits have not been respected. The Public Expenditure and Financial Accountability (PEFA) assessment[10] revealed that between 2006 and 2008 the Executive did not adhere to the approved budget amounts for the statutory funds transfers.

2.5 Role of civil society organizations in economic governance

Civil society organizations in Ghana are very active and play a major role in keeping the government on its toes through press releases, reports from conferences, and researches on the economy. The key among them are the Centre for Economic Policy Analysis (CEPA), Institute of Economic Affairs (IEA), Integrated Social Development Centre (ISODEC), Institute for Democratic Governance (IDEG), and Centre for Democratic Development (CDD). These organisations continuously conduct routine researches on the economy and make public their findings. For instance, CEPA publishes "The Ghanaian Economy" every year, together with mid-year reviews on the economy; the CDD conducts the AFRO Barometer surveys periodically; the IEA disseminates findings on researches into the economy; the ISODEC always takes a centre stage in making the public aware of government policies which will have an adverse effect on especially the poor.

The CSOs also make major inputs into the government's annual budgets. The latest of such forum was the one held in August 2010. Issues discussed by participants at the forum centered on the Macroeconomic Framework, Education, Health, Water, Petroleum

10 *The purpose of the central government Public Expenditure and Financial Accountability (PEFA) Assessment has been to assess the current status of the Central Government of Ghana's Public Finance Management (PFM) systems, procedures and practices using the PEFA methodology*

Sector, Trade and Agriculture Sector, Gender Responsive Budgeting (GRB) Demands, Social Welfare and Social Protection. In all, twenty-five CSOs in various disciplines across the whole of Ghana took part in the forum. The forum was organized by the Center for Budget Advocacy of ISODEC in collaboration with UNDP-Ghana, to collate inputs into the 2011 budget statement and economic policy of Ghana.

2.6 Institutional Coordination

Management and coordination of the public debt is entrusted in the hands of the Bank of Ghana under Section 31 of the BOG Act (612) which states that, "The Bank shall be entrusted with the issue and management of government loans publicly issued upon the terms and conditions that are agreed between the Government and the Bank." However, in terms of decision on which debt instruments to use, the MOFEP is in-charge, while the Bank is responsible for the auctioning of the debt instruments.

The Minister of Finance and Economic Planning is the single authority mandated to contract loans on behalf of the Government. The ceiling for domestic borrowing is the net domestic finance (NDF) approved in the budget. Domestic debt management activities cover a wide range of activities including Sectorisation/ classification – "The Bank of Ghana's Research Department reclassifies and summarizes the debt data Domestic debt data are classified by maturity and by type of debt instruments. Short-term instruments correspond to treasury bills with up to 12 months maturity. Debt instruments with maturities of more than a year are classified as long-term instruments. Among long-term instruments there are government stocks, Government of Ghana Index Linked

Bonds (GGILBs), Treasury bonds, Bearer Bonds, Development Bonds, and other long-term government stocks.

The treasury department of the BOG has the function of collecting information on domestic debt from its own records, it also prepares weekly forecasts on domestic debt service payments a crucial activity in the domestic debt management process.''The database on domestic debt is managed by the Treasury Department of the Bank of Ghana. The Treasury Department manages a database on domestic debt and "uses a computer software "Treasury Manager" developed internally by the BOG's Computer Services. Officials enter in the database information on type of instruments issued, dates of issuance, maturity, repayment periods, interest rate, whether the debt instruments are marketable, to the bearer, and all other information pertinent to the debt operation. On a weekly basis the Treasury Department compiles a calendar of payments "Maturity Profile" with a calendar of projections of amortization and interest payments for the following weeks, month, year, and future payments for the different individual type of instruments.

This information is shared with the Research Department of the BOG. Also, the Treasury Department prepares a weekly report on the operations executed on behalf of the central government. The weekly report is released during a weekly meeting with officials of the concerned of departments of the MOPEP, the Controller Accountant's Department, and the Research Department of BOG. The net result of the weekly debt operations conducted by the Treasury Department on behalf of the central government are credited or debited into the "Government Treasury Cash Account" in the form of a deposit or a disbursement (an overdraft operation is automatically extended to the central government if the balance in the Government Treasury Cash Account is not sufficient. All domestic debt amortization and interest payment are paid when they are due and there is no arrear payments related to the service of domestic debt.""The Treasury Department does not disseminate debt data to the public".

The issuance of domestic debt instruments is done through auctioning. There is an Auction Committee (AC) that is made up of representatives of the ADMD of MOFEP; Research, Banking, Treasury and Budget and Accounts Departments of BOG; and the Controller and Accountant General's Department (CAGD). Every Friday afternoon, the AC receives the weekly public sector borrowing requirements (PSBR) from the Treasury Management Committee (TMC). Depending on the week, the BOG may place an additional amount for the sale of Treasury bills for monetary policy purposes (i.e. liquidity management). The AC then issues a publication informing the public to submit their bids by the following Thursday at 3pm. The amount to be auctioned for the 2-3, and 5-year notes are announced in detail (by instrument). For the securities of maturity 1-year or less only the aggregate amount to be auctioned is announced. No information is provided on how much the total borrowing for PSBR is and how much is for liquidity management.

The BOG conducts the domestic debt auctions on behalf of MoFEP as per the legal framework, and for its own monetary policy implementation purposes. All relevant decisions associated with the auction, such as the timing and tenor, are the responsibilities of MoFEP and this is done based on the recommendations of the auction committee. The BOG has its own securities (i.e. the daily repo, 7 day, 14 day, 1 month and the 2 months BOG bills) for monetary policy implementation.

The Central Security Depository (CSD) of BOG keeps records of all holders of government securities, with reports generated from bids submitted to the ADMD. The ADMD monitors the debt profile using the Commonwealth Secretariat Debt Recording and Management System (CSDRMS) software. This software is managed by competent staff of the ADMD, who on weekly basis inform the Minister of Finance on the maturing periods of instruments already held by investors, which in turn informs the decision of the amount to borrow.

Information on public debt is made available to the public by BOG in its quarterly press releases, quarterly statistical bulletins and annual reports. This information is posted on the Bank's website. Other sources of information on public debt can be found in the government's annual budget statements and the websites of MOFEP and CAGD.

Debt management is enhanced by having the authority to incur loans being vested in a single authority; the Minister of Finance, subject to Cabinet and Parliamentary approval. However, this is grossly weakened by ignoring the ceilings on net domestic borrowings approved in the submitted budget. There are clear rules for in-year budget amendments that set out strict limits. These include rules on expenditure in advance of appropriation, expenditure out of the contingency allocation, vying, the use of supplementary budgets for expenditure beyond approved estimates; and the use of revote warrants. As per the Loans Act, 1970 the executive domestic debt may be incurred without each transaction being approved ex ante provided it does not exceed the approved budget domestic borrowing levels.

Section 3: Developments in Domestic Debt

This section discusses the structure and holdings of the domestic debt from 2000 to 2009. Analysis of the trend in the debt is also covered in this section. Of importance to the discussion are the reasons for government domestic debt and the evolution of the domestic securities market in Ghana.

3.1 Development of the securities market in Ghana

Before 1987, the main instrument of monetary management were direct controls in the form of ceiling on commercial bank credit to the private sector and regulation of the interest rates. The ceiling on commercial bank credit were both bank and sector specific by stipulating floors and ceilings for deposit and lending rates. High reserve requirements were also imposed during this period.

As part of the structural adjustment programme (SAP) the Financial Sector Adjustment Programme (FINSAP) was launched in 1987 to address the deterioration in the financial sector. Years of mismanagement and government interference in the administration of credit rendered most banks uncompetitive and technically insolvent. Hence, the institution of monetary policy reforms.

Government Securities were almost non-existent and so was the market for securities, making the government relying mainly on central bank borrowing to finance its deficit. A market for securities was created to be used for monetary policy purposes. In 1986 a weekly auction in treasury bills was introduced and in 1988 Bank of Ghana bills was introduced to take care of excess liquidity in the system especially in the rural areas. Around this time, there had been schemes to allow government to put its house in order and to move away from borrowing from the banking sector. The BOG bills were also to provide an avenue of investment for banks.

Further improvements in the money market for banks were undertaken. These include a 30-day bill to deal with the short-end of the market and a longer dated bill (182-day, 2 years). Other innovation in financial system was the introduction of 3-5 year bonds. All these were to pave the way for a full-fledged system of indirect monetary management.

By 1991, the restructuring and stabilization efforts began to produce results. Money supply growth fell below 20 per cent annually. Growth rate averaged 5 per cent per annum, while inflation fell to about 10 per cent. In 1992 all direct controls were abolished. Banks were free to set their own interest rates and formulate their own credit policies. The indirect system of monetary management was now under way.

Further, included in the classification of the debt is the revaluation stocks issued by government to the central bank in respect of losses incurred in the revaluation of net foreign assets owing to the depreciation of the currency. For a long time, this was on the books of the central bank, rendering its net worth negative, and creating operational problems for the Bank. In 1996, a decision was made to transfer the revaluation losses to Government in exchange for interest bearing stocks: this has since been part of the domestic debt.

In implementing monetary policy, Bank of Ghana intervenes mainly through the primary auction of treasury and BOG bills. Bank of Ghana introduced the wholesale auction system in March 1996. Tenders became restricted to only primary dealers – commercial banks, discount houses and brokerage firms. The essence was to help develop the secondary market. Since 1996 treasury bills became the main instrument of intervention because it serves in the government's debt management.

3.2 Composition of Domestic Debt Portfolio by Instrument

In 2000, instruments in the security market were mainly short-term and long-term ones. The short-term securities were Treasury bills issued in the maturities of 91-day, 182-day and 1-year Treasury note. The only available medium-term instrument was the 2-year floating Treasury note, while the long-term instruments comprised of long-term government stocks, revaluation stocks and other government stocks.

In September 2001, Bank of Ghana introduced a new instrument on the money market called the Government of Ghana Index Link Bond (GGILB) on behalf of the government. The instrument is a 3-year long-term bond. The objective is to restructure the government of Ghana holdings of short-term debt instrument (91-day bills) into long-term in order to give the government a respite on its high interest burden and also make some savings on interest payments. Both the principal and interest on GGILB are indexed to the Consumer Price Index (CPI).

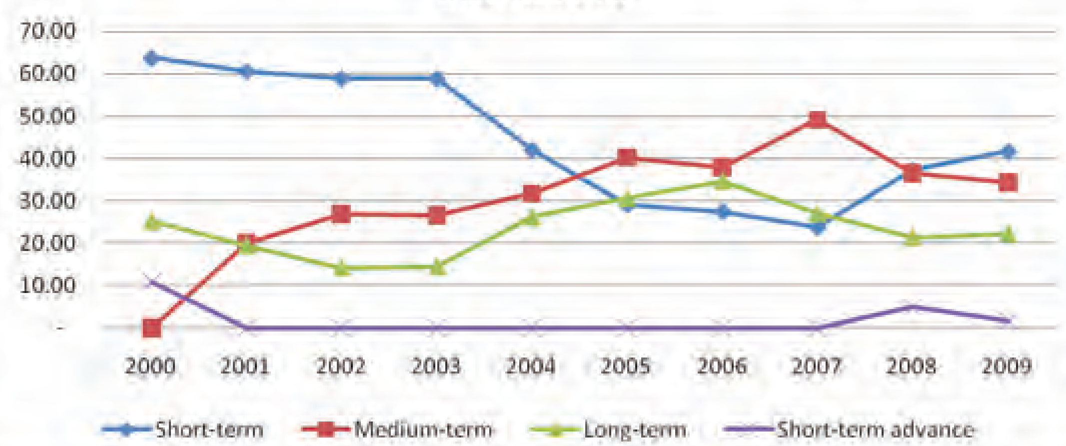
The operations of Tema Oil Refinery (TOR), a state-owned enterprise, continued to pose monetary and quasi-fiscal problems. In 2001, government took over part of TOR's indebtedness to the banking system by converting GH¢97.9 million into 3-5 year bonds[11]. At that period, the Bank of Ghana remained exposed to

11 The purpose of the central government Public Expenditure and Financial Accountability (PEFA) Assess ment has been to assess the current status of the Central Government of Ghana's Public Finance Management (PFM) systems, procedures and practices using the PEFA methodology the Ghana Commercial Bank (GCB) to the tune of GH¢90 million on account of a margin deposit placed with GCB on behalf of TOR. This situation has remained because TOR is unable to finance crude oil imports from its own resources.

Other medium-term instruments were introduced in 2004, namely, the 2-year fixed Treasury note, 3-year fixed Treasury note, 3-year floating Treasury note, 5-year Government of Ghana bond, and Government of Ghana petroleum finance bond.

The sale of Treasury Bills/Notes at the weekly auctions increased quite appreciably in year 2000 (fig 1) mainly as a result of increased borrowing by government to finance a higher than projected deficit and inadequate external financing. The worsening terms of trade of cocoa and gold, the country's major exports, and the hike in crude oil prices led to a huge financing gap, and the only avenue left to the government was to borrow from the domestic market.

Fig 3.1: Percentage Distribution of Domestic Debt by Instruments



Source: Bank of Ghana

Short-term instruments accounted for more than 60 per cent of domestic debt stock in 2000 (fig 3.1), and remained the largest until 2004. However, there was continues shift in portfolios away from holdings of shorter-dated securities, and in favour of longer-dated securities between 2000 and 2007. With the introduction of more medium-term instruments and a long-term Telekon Malaysia stock, there was a shift in domestic debt stock composition towards the medium-term and long-term instruments between 2005 and 2007. In 2009, domestic debt stock was held more in short-term instruments than the others.

The proportion of the 91-day Treasury bill in the overall domestic debt reduced from the 2000 level of 45.5 per cent to 20 per cent in 2004, before reducing further below 10 percent over the next three years. It however increased sharply in 2008 to 17.6 per cent and declined to 10.7 per cent in 2009 (Table 3.1). An average of 18 per cent of the domestic debt between 2000 and 2005 was held in 182-day Treasury bill, but became the largest single debt instrument in 2009, holding 29 per cent of the debt stock. The 1-year Treasury note had the highest proportion among the other short-term instruments between 2005 and 2007 (Table 3.1).

Table 3.1: Percentage distribution of domestic debt by instrument

Type of Instrument	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
A.Short-Term Instruments	**63.9**	**60.8**	**59.0**	**59.0**	**42.0**	**29.1**	**27.4**	**23.7**	**37.3**	**41.7**
91-Day Treasury Bill	45.5	36.2	34.2	30.1	20.0	7.0	7.8	6.6	17.6	10.7
182-Day Treasury Bill	18.2	22.7	18.3	19.6	15.9	10.6	4.5	3.6	13.9	29.0
1-Year Treasury Note	0.2	1.9	6.5	9.3	6.1	11.4	15.2	13.5	5.8	2.0

B. Medium-Term Instruments	**0.0**	**19.9**	**26.8**	**26.5**	**31.7**	**40.2**	**37.9**	**49.2**	**36.5**	**34.3**
2-Year Floating Treasury Note	0.0	-	-	-	-	14.5	4.8	1.1	0.1	-
2-Year Fixed Treasury Note	-	-	-	-	9.5	12.1	16.5	18.2	11.1	16.5
3-Year GGILBS	-	10.3	-	-	2.0	1.2	0.0	-	-	-
3-Year Floating Treasury Note	-	-	9.5	10.6	3.0	0.7	0.5	0.1	-	-
3-Year Fixed Treasury Note	-	-	-	-	0.7	1.5	5.2	17.4	15.7	10.3
5-Year GOG Bond	-	-	-	-	0.9	-	2.6	7.2	5.6	4.4
GOG Petroleum Finance Bond	-	-	-	-	4.7	4.4	2.8	2.2	1.7	1.3
TOR Bonds	-	9.6	17.3	16.0	11.0	5.8	5.4	3.0	2.3	1.8
C. Long-Term Instruments	**25.2**	**19.4**	**14.2**	**14.5**	**26.2**	**30.7**	**34.7**	**27.1**	**21.4**	**22.2**
Long Term Government Stocks	7.5	5.8	4.2	4.3	3.5	-	14.6	11.4	8.8	12.3
Telekon Malaysia Stock	-	-	-	-	-	3.5	3.0	2.4	2.3	1.8
Revaluation Stock	16.6	12.8	9.4	9.5	22.6	27.0	17.0	13.3	10.3	8.1
Other Government Stocks	1.1	0.8	0.6	0.6	0.1	0.1	0.1	0.1	0.0	0.0
D. Short Term Advance	**10.9**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**4.9**	**1.7**
Total Domestic Debt Stock	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Authors calculations from the Aid and Debt Management Division (ADMD) data

Developments in the money market reflected a shift in preference towards short-dated securities due to heightened inflationary pressures in 2008. The share of short-dated securities (91-day and 182-day treasury bills) in the outstanding stock of government securities more than doubled to 45.7 per cent in 2008, compared with the 20.5 per cent recorded in 2007. Comparatively, the share of 1- and 2- year fixed notes declined by 10.3 per cent and 4.1 per cent respectively.

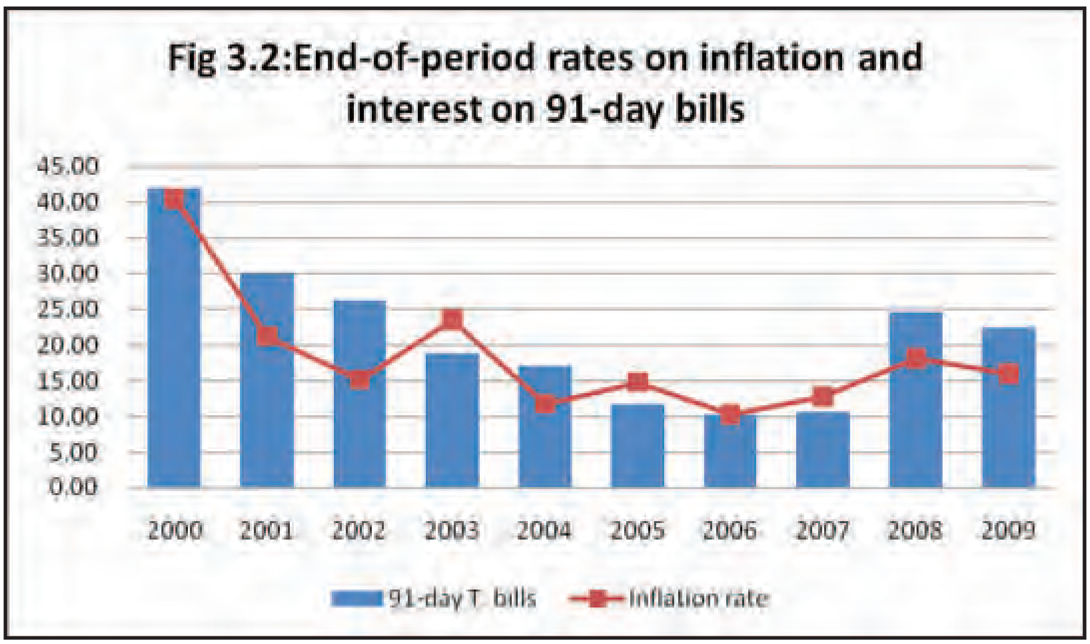


Fig 3.2:End-of-period rates on inflation and interest on 91-day bills

Source: Bank of Ghana

The end-period interest rates on the 91-day Treasury bills were higher than end-period inflation rates throughout the period, except in 2003, 2005 and 2007. As shown in fig 3.2, there is some correlation between the 91-day Treasury bill rates and the inflation rate.

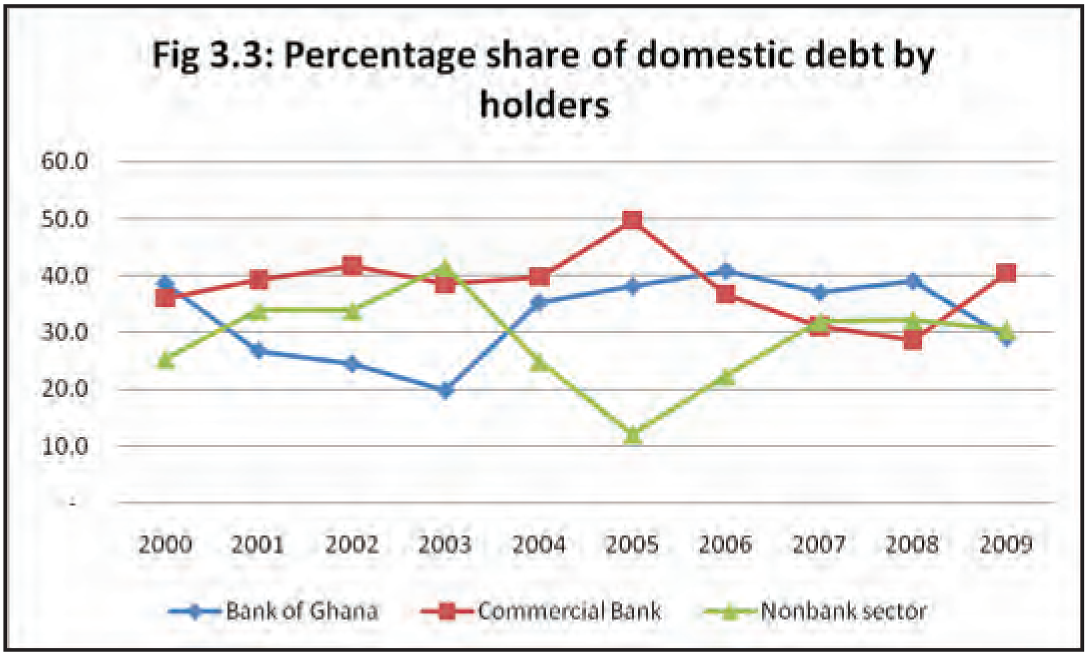
The Bank of Ghana is intensifying the use of interest rate policy to achieve monetary policy objectives. The treasury bills rates reflect market developments. This entails maintenance of real positive rates for money market instruments to provide appropriate signals to financial institutions on interest rates. Banks are responding to this by developing new instruments to attract savings and deposits and new lending scheme for investments purposes.

There are other non-securitized liabilities which are officially neglected in the computation of the gross domestic debt. Government has been postponing honouring its obligations to some contractors, particularly those in the road sector. There are other non-road arrears that are taken care of within the short term. These comprise of arrears owed to the district assemblies' common fund (DACF), the Ghana Education Trust Fund (GETFund), salaries and other payments to suppliers. This has created a stock of payment arrears.

3.3 Holders of domestic debt

As shown in fig 3.3, the holding structure of domestic debt is not dominated throughout the study period by one holder, though the commercial banks have held the largest for half of the period. The only period that recorded a yawning gap between the largest and least holder was in 2005, when the commercial banks held about 50 per cent of the debt against 12 per cent by the nonbanks.

A wider investor base plays a major role in ensuring that the government meets its domestic borrowing requirements at reasonable costs. A narrow investor base consisting mainly of commercial banks increases the risk of crowding-out private sector investment as private companies depend mainly on commercial bank financing, Christensen (2005).



Source: Bank of Ghana

3.4 Evolution of the domestic debt, 2000-2009

Managing the budget to achieve the Government's policy objectives is always a challenge given competing spending demands and the multiple financing sources, some discretionary, others tied to particular expenditure categories. Domestic debt had been growing steadily from the 2000 position of GH¢784.2 million[12]. By the end of 2005, it rose to GH¢1,823.9 million and sharply to GH¢2,893.7 million by the end of 2006. The sharp rise is mainly attributed to the floatation of more indexed medium term instruments especially the 2-year Fixed Treasury Notes, 3-year Fixed Rate Bond and the 5-year GOG Bond. Domestic debt stock rose further to GH¢3,708.2 million in 2007 and again to about GH¢4.8 billion by end of 2008. Thus, the country's fiscal position was allowed to slip in 2006. Government expenditure rose faster than revenue collections, causing the fiscal deficit to widen.

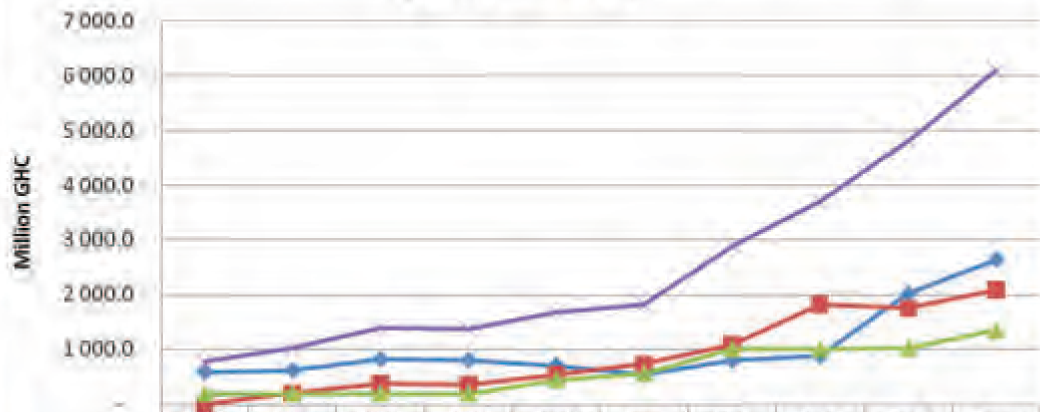
12 US$1/GH¢1,4334

Fiscal transactions under the broad coverage in 2000 resulted in a deficit of GH¢275.04 million (7.2% of GDP) compared with a budgeted deficit of GH¢340.56 million (9.0% of GDP). The deficit was financed through a net domestic borrowing of GH¢862.1 million and a net foreign inflow of GH¢188.83 million. The domestic primary balance, however, showed a surplus of GH¢144.44 million (3.8% of GDP) compared with a target of ¢1,368.3 billion (3.6% of GDP). In the year 2000, the domestic primary balance recorded a surplus equivalent to 2.3 per cent of GDP.

The total stock of domestic debt at the end of year 2001 stood at GH¢1,019.47 million (26.8 per cent of GDP), showing an increase of GH¢235.23 million during the year. This resulted from increases in Treasury bills of GH¢100.74 million, Government stocks GH¢17.58 million, GGILBS GH¢104.52 million and TOR bonds of GH¢97.94 million (fig 3). The outstanding short-term advance of GH¢85.56 million as at end December 2000 was repaid during the 2001 fiscal year.[13]

13 Annual report of Bank of Ghana, 2001

Fig 3.4: Trends in Domestic Debt by Instrument (GHc million)



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Short	586.6	619.4	820.6	805.2	710.4	529.9	793.3	880.2	2 022.6	2 643.1
Medium	0.0	202.46	372.74	362.39	536.44	734.14	1 096.	1 823.	1 752.5	2 087.7
Long	197.6	197.6	197.6	197.6	442.9	559.9	1 004.	1 004.2	1 025.1	1 352.3
Total	784.2	1 019.	1 390.	1 365.	1 689.	1 823.	2 893.	3 708.	4 800.	6 083.

Source: Bank of Ghana

The 2002 budget deficit of GH¢298.64 million together with a net foreign inflow of GH¢46.07 million and savings of GH¢19.40 million made from the issue of inflation index bonds resulted in a net domestic resource gap of GH¢233.17 million. This was financed by borrowing of GH¢113.71 million from the banking sector and GH¢119.46 million from the non-bank public. The stock of domestic debt increased by GH¢371.48 million to GH¢1,390.94 million at the end of 2002. This was due to an increase of GH¢130.22 million in short-term instruments and GH¢241.25 million in long-term instruments. The long-term instruments included GH¢142.10 million new debt accrued by the Tema Oil Refinery (TOR) which was restructured into bonds. The holdings of the domestic debt were as follows: Commercial Banks 41.7 per cent, Non-bank public 29.4 per cent, Bank of Ghana 24.2 per cent and SSNIT 4.5 per cent.

The net domestic financing of the budget amounted to GH¢39.27 million in 2004 as against the net repayment of GH¢5.49 million recorded for 2003. While there was a net borrowing of GH¢163.99 million from the banking sector, the Government made a net repayment of GH¢124.73 million to the non-bank public. Foreign resources continued to make significant contribution to financing the deficit by way of programme and project loans as well as exceptional financing. Outturn for 2004 indicated that savings from HIPC initiative amounted to GH¢106.48 million (42% of net foreign inflows).

The stock of domestic debt at the end of 2004, stood at GH¢1,689.7 million (21.6% of GDP), showing an increase of GH¢339.57 million over the level of GH¢1,359.15 million (20.83% of GDP) in 2003. This increase in the debt stock at the end of the year was on account of an increase in Revaluation stock of GH¢251.44 million and new Government of Ghana Petroleum Finance Bond of GH¢80.02 million.

The outturn for the 2005 budget indicated that the execution of the government budget was broadly on target and on the path of domestic debt reduction. Data for the year indicated that fiscal operations resulted in a domestic primary balance estimated at GH¢330.1 million (3.4% of GDP), significantly above the GH¢53.6 million (0.7% of GDP) attained in 2004 and marginally above the budgeted target of 2.8 percent. The fiscal position also showed a narrow budget surplus of GH¢211.6 million (2.2 percent of GDP) and a domestic debt repayment of GH¢126.1 million, compared with a targeted repayment of GH¢0.996 million for 2005. This has entailed a reduction in the domestic debt to GDP ratio (net) from 15.2 percent in 2004 to 11.1 percent in 2005; and compares with 21.0 percent in 2001.

Total government expenditure (excluding foreign financed capital projects) for 2005 amounted to ¢26,898.3 billion (27.7% of GDP), or 3.0 percent above the budget estimates and 13.9 percent higher than the ¢23,603.1 billion recorded in 2004.

Revenue growth was robust relative to the 2004 outturn. Total domestic revenue (tax and non-tax) amounted to GH¢2,563.43 million compared to a budget target of GH¢2,411.62 million and was 23.8 percent above the 2004 outturn. However tax collections of the revenue agencies fell short of target while non-tax revenue exceeded targets, bolstered by increased collection of non-tax revenue in the fourth quarter which enabled the government meet its domestic debt reduction target in 2005.

In previous years, there has been a steady increase in the wage bill partly reflecting employment increases and partly correcting historically low levels of pay. The main driver of government spending has been the wage bill, reaching almost 10 percent of GDP as a result of pay awards that triggered further requests for pay increase within the public sector. In 2006 the wage bill increased sharply between the first and second halves of the year. Whilst the average remuneration of staff of the Ghana Education Services (GES), largest component of the wage bill, grew by 23 percent, remuneration of health service staff, the second largest, increased by 181 percent, with an overall increase in average remuneration for all employees of 44 percent. These variations reflected the separate approaches taken to wage negotiation, and, in the case of health, the perception that action was needed to prevent the further loss of skilled staff to the private sector and abroad.

Total expenditure amounted to GH¢4,009.42 million, 3.1 per cent higher than projected and 34.1 per cent higher than the total outlay in 2005. The share of total expenditure in GDP was 33.2 per cent. These developments resulted in a budget deficit of GH¢897.09 million (7.8% of GDP) compared with the end-year target of GH¢510.0 million (4.5% of GDP) and an actual deficit of GH¢223.3 million (2.3% of GDP) at the end of 2005.

The deficit for the year, together with a net foreign in-flow of GH¢224.97 million, exceptional financing of GH¢92.7 million and payments arising out of maturing GGILBs, led to higher net domestic financing (NDF) of GH¢476.52 million (4.24% of GDP) compared with a target GH¢20.5 million (0.9% of GDP). The main reasons for the higher borrowing were unanticipated transfers to VRA as a result of the energy crisis and higher wage demands. Consequently, the domestic debt-to-GDP target of 8.7 per cent was not realised, as the year ended with a ratio of 14.7 per cent.

There was also a shift from the short-term instruments towards the medium and long-term instruments, with these two instrument categories accounting for 72.6 per cent of the debt. The Bank of Ghana held 40.9 per cent of the debt, 36.7 per cent by the commercial banks, and the remaining by the non-banks.

By July 2007 interest payments on public debt had already exceeded its budget ceiling by 30 percent.[14] Also, higher spending on wages and salaries have meant that Ministries with large payrolls (e.g., Education and Health, which together account for over two-thirds of payroll expenditures) have experienced the largest increase in

14 *Page 7 of the July 2007 CAGD report and financial statements on the consolidated fund*

expenditures. Thus, by mid-2007 the government had responded to the need for fiscal space for energy-related and payroll expenditure with an across-the-board 30 percent reduction in the budget ceilings for services and non energy-related capital expenditures.

Total government expenditures increased from GH¢5,624.53 million (40.0% of GDP) in 2007 to GH¢8,009.82 million (46.5% of GDP) in 2008. The strong fiscal stimulus observed during the year was mainly the result of high energy-related expenses, infra-structural developments and the social mitigating expenditures. The huge public sector personal emoluments bill (the single highest item of expenditure) continued to exert pressure on government finances, registering a growth of 27.4 per cent and constituting 37.8 per cent of recurrent expenditure.

The net effect of these fiscal developments was an overall deficit of GH¢2,390.13 million (13.9% of GDP) on commitment basis compared with GH¢849.46 million (6.1% of GDP) programmed for the year. On cash basis, the overall balance (including divestiture) was a deficit to GH¢1,976.5 million (11.5% of GDP) compared with the programmed amount of GH¢653.4 million (4.5% of GDP). The deficit was financed by domestic borrowing amounting to GH¢1,152.7 million (58.3%) and the remaining 41.7 per cent was foreign financed.

The 2009 national budget was designed to maintain momentum in revenue generation while improving the efficiency of government expenditure. The pursuance of these objectives was however not without challenges which included the reduction in tariff on petroleum products and the non-restoration of import duty on some major food items. These were measures put in place in 2008 to reduce the severity of the effects of the global food crisis. Also the government had to devise mechanisms to reduce the huge domestic arrears in order to remain consistent with the prudent expenditure management that had been envisaged. In the face of these challenges, government fiscal policy objective was to reduce the overall budget deficit excluding divestiture from 14.5 per cent registered in 2008 to 9.4 per cent in 2009.

Total government revenue and grants in 2009 amounted to GH¢6,775.2 million (31.2% of GDP) indicating a shortfall of GH¢697.3 million (3.2% of GDP) from the budgeted estimates. Direct tax collections over-performed, reflecting strong increases in personal income taxes following the computerisation of income tax payments and compliance enforcement, an upward revision of up to 50 per cent in airport tax and the introduction of National Fiscal Stabilisation Levy. Indirect taxes, especially VAT collections, registered a shortfall due to weak consumer demand stemming from the impact of the economic slowdown. Receipts of Grants fell short of budgeted levels by 0.9 per cent of GDP reflecting capacity constraints and slow disbursement procedures. Expenditure arrears from 2008 posed a challenge to fiscal management in 2009. Constrained by limited resources, government restrained expenditures to GH¢8,248.2 million (38.1% of GDP), lower than the budgeted sum of GH¢8,836.6 million (40.9 % of GDP). Both recurrent and capital expenditures were within the budgeted levels, despite an overrun in the wage bill by 1.4 per cent of GDP and domestic interest payment by 0.7 per cent of GDP.

The overall fiscal outturn for 2009 was a deficit on cash basis of GH¢2,056.2 million (9.8 % of GDP) compared with the budget estimates of GH¢2,028.3 million (9.4 % of GDP). The domestic primary balance, however, was a surplus of GH¢25.5 million (0.6% of GDP) in sharp contrast to the budgeted deficit of GH¢293.6

million (1.4% of GDP). The deficit was financed by net domestic borrowing of GH¢1,042.1 million and net foreign inflow of GH¢1,014.2 million.

The stock of domestic debt (including revaluation stocks) rose by GH¢1,283.0 million to end the year at GH¢6,083.2 million (28.1% of GDP). The growth in the debt stock reflected mainly in the Short-Term securities which increased by GH¢620.5 million while that of the medium and long-term securities went up by GH¢335.2 million and GH¢327.2 million respectively. T his was contrary to the government debt management strategy of restructuring the government debt from Short-Term into medium-term securities.

Bank of Ghana's holding of domestic debt as at the end of 2009 stood at GH¢1,754.3 million (28.8%), down by 10.2 percentage points compared to holdings as at the end of 2008. The Commercial Banks held GH¢2,482.3 million (40.8%) indicating an increase of 12.1 percentage points over their holdings for 2008. SSNIT held GH¢246.7 million (4.1%), while the Insurance companies held GH¢52.8 million (0.9 %) and "Other" holders comprising individuals, rural banks, firms and Institutions as well as foreign investors held GH¢1,547.0 million (22.4%).

3.5 Publicly guaranteed debt and contingent liabilities

Some of the main risks to fiscal sustainability come from contingent liabilities, including publicly guaranteed debt. Contingent liabilities refer to obligations that may become government liabilities, whose size and timing is dependent on the occurrence of some uncertain future event outside the control of government. Such occurrences can include the central government having to assume the debt servicing costs should a state enterprise default on a publicly guaranteed loan, rescue failing banks as part of a financial sector bailout, or recapitalise a public pension or a central bank. At a time of international financial crisis, it is essential to have good information and an assessment of such fiscal risks, especially because the private sector and non-central government public sector are likely to experience greater than normal problems with rollovers and servicing.

All state-owned non-performing enterprises were put on divesture. There is however some important state-owned enterprises which cannot be divested because of the essential services they provide to society. These enterprises have the problems of pricing of their output which are influenced by the government. They are not allowed to charge economic prices to make them self-financing. Government promises of settling the subsidies granted the consumers of these services to the enterprises are also not fulfilled. It therefore makes sense for government to take over their liabilities whenever they are in crises. Some of them also have in their books huge unpaid bills by government ministries and departments. Such companies still remaining under the review period are TOR, VRA, Ghana Water Company Limited, Ghana Airways (defunct) and Ghana Telecom (divested in 2008).

The Government of Ghana adopted a strategy of settling some of the contingent liabilities through issuance of Treasury bonds. Such contingent liabilities in the domestic debt profile are the TOR bonds, Government of Ghana petroleum finance bonds, and Telekon Malaysia stocks.

Although settling of contingent liabilities through issuance of special bonds has its merits in strengthening the financial position of the institutions involved, it can lead to a rapid accumulation of domestic debt beyond the sustainable levels provided for in the fiscal framework. For instance, the conversion of GH¢142.1 million TOR debt into Government of Ghana bonds in 2002 contributed to about 14 per cent of the total change in debt stock.

Table 3.2 shows the proportion of government guaranteed debt in Ghana's external debt stock. The proportion has been reducing since 2004 to a level of 1.9 per cent by the end of May 2010. As long as the government continues to regulate the pricing of the output of the public utility and the oil refinery (TOR), government will continue servicing their debts.

Table 3.2: External Debt by Borrower Category (US$ million)

Year	Government Debt (GD)	Government Guaranteed Debt (GGD)	GGD/GD (%)
2001	5,492.69	532.92	9.7
2002	5,536.68	594.62	10.7
2003	6,673.37	875.53	13.1
2004	6,179.97	267.92	4.3
2005	6,086.37	259.43	4.3
2006	2,015.36	161.21	8.0
2007	3,438.29	147.64	4.3
2008	3,903.97	131.10	3.4
2009	4,902.76	105.12	2.1
2010 May	4,944.97	96.21	1.9

Source: Aid and Debt Management Division, MoFEP

As shown in Table 3.3, government guaranteed loans for only three state-owned enterprises from 2007 to 2009. While the GCAA has the potential of repaying its debts, the same cannot be said about the other two because of the regulated output pricing.

Table 3.3: Government Guaranteed Loans by Debtor Institution (million US$)

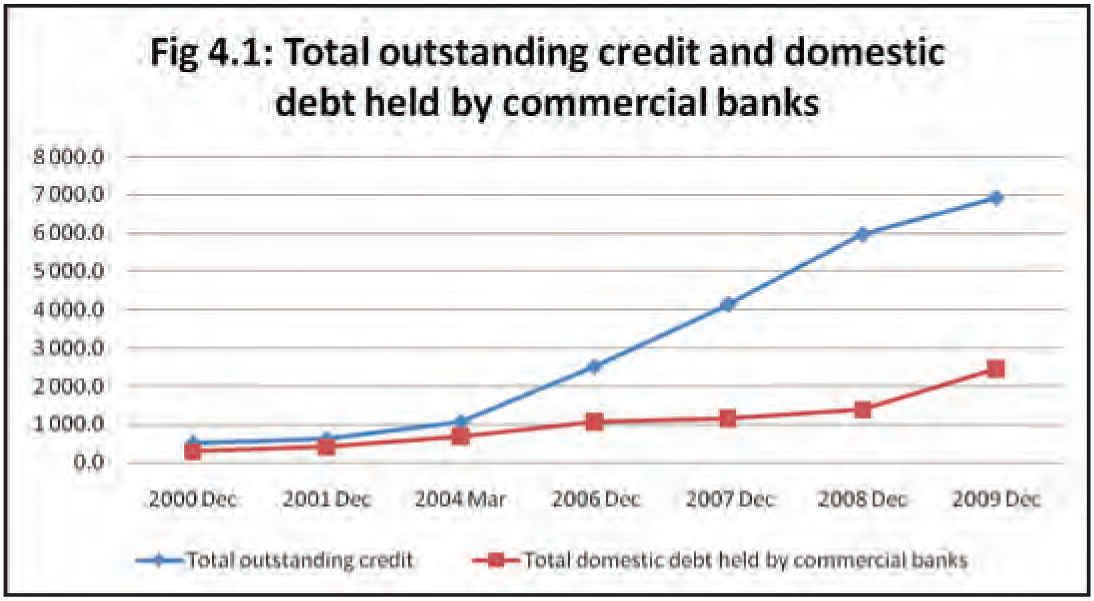
State-Owned Enterprise	2007	2008	2009
Volta River Authority (VRA)	65.75	70.49	65.81
Ghana Civil Aviation Authority (GCAA)	11.13	5.57	0
Tema Oil Refinery (TOR)	70.76	55.04	39.31
Total	**147.64**	**131.10**	**105.12**

Source: Aid and Debt Management Division, MoFEP

Section 4: Impact of Domestic Debt on the Economy

The domestic debt has both fiscal and monetary consequences. Because government needs to borrow more to take care of the debt due and also to close the fiscal gap, interest rates are kept high and attractive. As discussed earlier, interest rates on 91-day Treasury bills were higher than the inflation rate for most part of the period under review. The high interest rates worsen the debt burden and cause government to borrow more to service it. As pointed out by Christensen (2005), if the debt portfolio consists mainly of short-term debt, the government faces considerable risks, as the government becomes more vulnerable to sudden increase in interest rates due to frequent rollovers.

Another risk concerns the crowding out of private investment. Interest rates on financial securities are made attractive in order to draw domestic private savings that would otherwise be available to the private sector. This can lead to credit rationing and crowding out of private sector investment. The commercial banks have been holding an average of 38.2 per cent of the debt over the period under review, with holdings of over 40 per cent recorded in 2002, 2005, and 2009. These funds could have been made available to the private sector for investment.



Source: Bank of Ghana

However, fig 4.1 does not support any crowding out of credit to the private sector. During the study period, as total debt held by the banks increase, credit to the private sector even increase faster. The effect was an upward adjustment in lending rates to the private sector. The lending rates have been about 10 percentage points above the Treasury bill rates.

As shown in Table 4.1, interest payments on domestic debt are far higher than that of external debt. Interest payments on domestic debts over the study period are an average of 75 per cent of total interest payments. Between 2000 and 2003, and in 2009 interests paid on domestic debt were higher than domestically financed capital expenditure. Thus, the level of interest payments weakens the ability to provide community services in accordance with its legal mandate, and with adequate coverage and quality.

Table 4.1: Interest payments by debt category and capital expenditure by Source of financing (GH¢ million)

	Interest Payments			Capital Expenditure	
Year	Total	Domestic	External	Total	Domestically financed
2000	2,033.39	1,446.22	587.17	2,529.98	1,184.20
2001	2,787.24	2,309.54	477.71	2,856.04	1,211.28
2002	299.90	221.00	78.90	281.41	116.25
2003	363.34	278.69	84.66	547.18	239.61
2004	347.24	254.50	92.74	808.19	347.08
2005	347.38	262.25	85.13	972.68	378.08
2006	393.37	303.09	90.28	1,096.18	568.32
2007	440.01	322.19	117.82	1,630.22	903.80
2008	679.18	481.93	197.25	2,471.31	1,564.77
2009	1,032.32	773.50	258.82	2,328.45	701.83

Source: Ministry of Finance and Economic Planning

The ratio of interest payments on domestic debts to domestic revenues reduced from the 2002 level of 22.6 per cent to 10.1 per cent in 2007, before rising to 15.6 per cent in 2009. The same trend is shown with respect to domestic expenditures. The ratio declined from 25.3 per cent in 2002 to 7.9 per cent in 2007, rising sharply to 15.8 per cent in 2009.

Despite the attractiveness of foreign borrowing, governments may still consider domestic borrowing for a number of reasons. First, the supply of foreign (concessional) financing may be determined by the aid agencies' budgets and their assessment of the economic performance of the recipient country. Second, international aid is very often linked to project financing and therefore cannot finance a government's recurrent expenditures or capital projects not supported by donors. Hence, governments with large recurrent budget deficits may be forced to tap domestic savings, including through issuance of domestic debt, to close their budget gaps (Christensen, 2005).

Section 5: Domestic Debt Sustainability Analysis

According to Berensmann (2004), debt sustainability can be defined in many different ways, and two of the simple definitions are as follows: (a) economic debt sustainability which means that debt service does not inhibit growth, and (b) the overall economic policy and financial debt sustainability means that a country is able to service its debt.

As domestic debt is generally issued on market terms, unlike external debt which is usually contracted on concessional terms, it is common practice to assess the solvency of domestic debt and total public sector debt in nominal, rather than present value, terms[15]. The main macroeconomic denominator used to reflect the capacity to repay domestic and total debt should preferably be domestic budget revenue, measured excluding any temporary or one-off current or capital revenues (such as proceeds from sales of assets). Ratios related to GDP are much less precise measurements of the fiscal burden of debt than ratios related to revenue.[16]

5.1 Domestic debt sustainability assessment

To date there are no internationally agreed indicators or benchmarks for assessing domestic debt and total public debt sustainability. However, there are a number of ratios and thresholds currently being used, and the key among them, according to the Debt Relief International (2001) as presented in Table 5.1.

15 In the case when the present value of total public debt is calculated, the present value of domestic debt is usually valued at par with its nominal value.

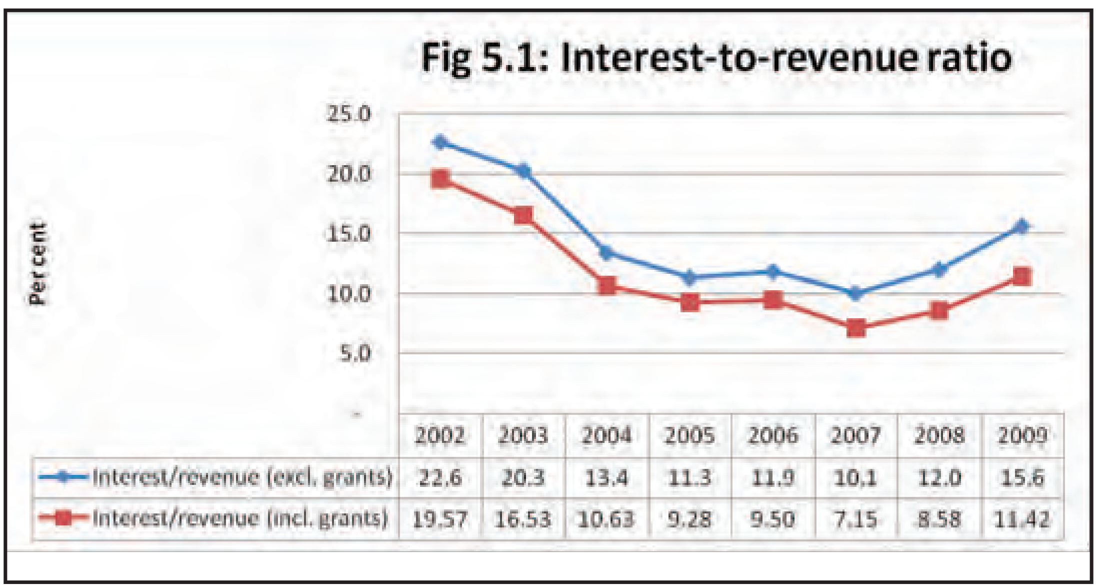
16 Joint Ministerial Forum on Debt Sustainability - Development Finance International (DFI), CEMLA and Commonwealth Secretariat

Table 5.1: Benchmarks for Debt Sustainability

Domestic debt indicator	Thresholds range (%)
Total debt service/revenue	28 – 63
Interest/ domestic budget revenue	4.6 - 6.8
Debt/GDP	20 – 25
Debt/domestic budget revenue	92 – 167

Source: Debt Relief International (2001)

Interest/domestic budget revenue ratio measures the interest cost of domestic debt. The larger the numerator with respect to the denominator, the larger the ratio. In analysing the trend of the ratios as presented in fig 5.1, the interest cost of domestic reduced from its high level of 22.6 per cent in 2002 to 10.1 per cent in 2007, before rising to 15.6 per cent in 2009. Using both ratios which involve domestic budget revenues with or without grants did not make the country's debt sustainable. If the current trend continues, then the country will soon be using more of its revenue in servicing interest on domestic debts.



Source: Author's computation

Debt stock/domestic budget revenue ratio measures the level of domestic indebtedness relative to the government's ability to pay. It demonstrates the number of years of revenue required to repay the entire debt stock. For this ratio, the country is within the threshold over the period under review. The rising ratio should be checked in order not to exert more pressure on the government budget.

Fig 5.2: Debt-to-revenue ratio

	2002	2003	2004	2005	2006	2007	2008	2009
Debt/revenue (excl. grants)	142.4	99.3	88.9	78.8	113.2	116.1	119.4	123.0
Debt/revenue (incl. grants)	123.19	80.97	70.59	64.55	90.66	82.25	85.42	89.79

Source: Author's computation

Debt stock/GDP ratio measures the country's indebtedness relative to the country's economic activity. It is a measure used to assess the sustainability of a country's debt burden. It implicitly assumes that all of GDP is accessible for financing the domestic debt burden, which is not necessarily the case.

After falling from 28.5 per cent in 2002 to 18.8 per cent in 2005, the sharp rise in domestic debt afterwards pushed the ratio to the 2002 level in 2009 (fig 5.3). The country was able to might the sustainability criteria between 2003 and 2006. Like the other two ratios, if the trend is not controlled the debt burden will be unsustainable.

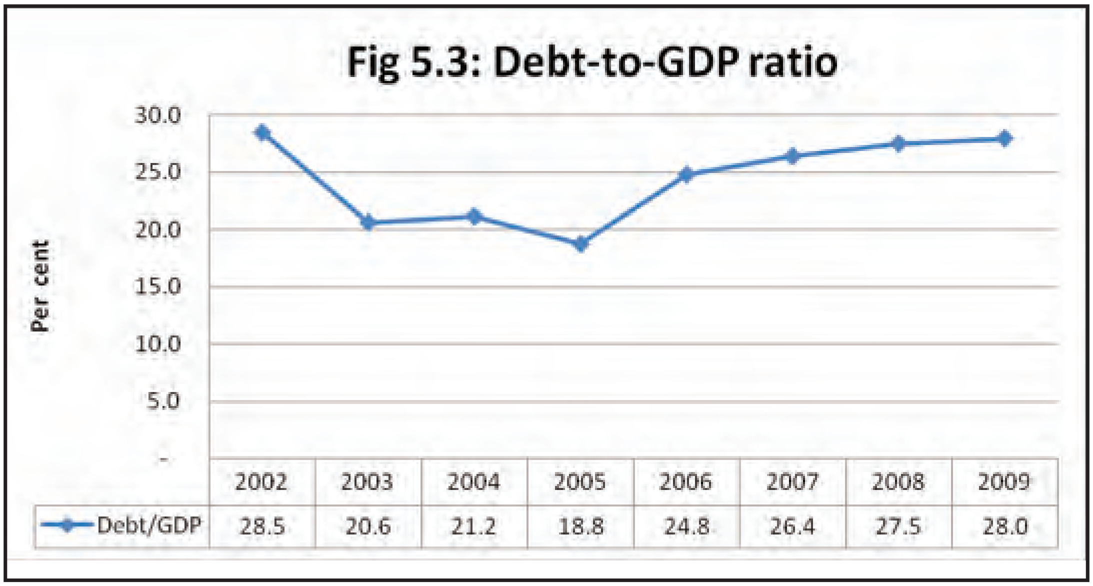


Fig 5.3: Debt-to-GDP ratio

Source: Author's calculation

The IMF describes the domestic debt burden as significant when the ratio of nominal domestic debt stock to GDP ratio is above 15% - 20% and it recommends that IMF staff thoroughly review the risks in such cases when doing debt sustainability analyses in low-income countries[17]. Considering this threshold, Ghana domestic debt is unsustainable.

A highly expansionary fiscal position financed by borrowing triggered a very rapid deterioration in the debt sustainability ratios after the HIPC completion point. Avoiding future such episodes of debt deterioration will require more determined fiscal management as well as more cautious debt management policies. A debt analysis study (DSA) done on Ghana by IDA-IMF staff[18] concluded that, failure to reduce the primary deficit from 2009 levels would be associated with a near doubling of the public debt-to-GDP ratio over two decades.

17 This is contained in a paper prepared by Development Finance International (DFI) for Government of Guyana as Chair of Commonwealth Ministerial Debt Sustainability Forum (CMDSF), funded by DfID

18 This debt sustainability analysis (DSA) updates that prepared for the 2009 Article IV consultation

Government is making efforts to manage the debt but the fiscal stance for the first half of 2010 depicts missing of expenditure targets. Total expenditure (excluding externally financed capital expenditure) was 1.7 percent more than budgetary projection, driven mainly by overruns in discretionary spending. In year-on-year terms, the pace of domestic expenditure has increased from 8.2 percent in the first half of 2009 to 20.4 percent as at June 2010. The outturn in statutory payments represented some 86 percent of the half year target suggesting possible accumulation of arrears.

Domestic debt rose from GH¢6,083.19 million or) at the end of December 2009 to GH¢7,241.92 million (27.9% of GDP, higher than threshold) by the end of June 2010. Total interest payments for the period under review amounted to GH¢688.87 million compared with GH¢449.0 million paid in 2009, which represents an outturn of 13.8 percent more than the half year target. The year-on-year growth in interest payment on domestic debt for the first half of 2010 was a 59.3 per cent over the 2009 payments.

Against a rising expenditure, the pace of growth in domestic revenue mobilization has however slowed, in year-on-year terms, to 25.3 percent from 30.0 percent for the corresponding period in 2009. The expectation of a possible accumulation of arrears and the implementation of the new salary structure, the budget deficit is expected to widen by close of year. Domestic debt burden is likely to deepen against government's promise of cutting down the debt in 2010.

5.2 Likely impact of the discovery of crude oil on Ghana's fiscal sustainability

A joint IDA and IMF staff completed a DSA report on Ghana on April 2009. The macroeconomic assumption for the DSA baseline is that the government pursues prudent economic policies to foster stable macroeconomic conditions. In the light of this, a decline in inflation to single-digit levels and strong productivity growth would to support broad-based growth in the non-extractive sectors.

In the report, oil production is assumed to average 120 thousand barrels per day during 2012-15, with a subsequent steady decline. Based on the latest world economic outlook (WEO) projections, the price of Ghana's oil exports would increase to US$83 per barrel by 2014; prices are assumed to stabilize at this level over the medium term in nominal terms. Oil revenues are projected to peak at about 6 percent of GDP during 2011-2017. The government's incomes reflect a combination of income tax and royalty collections, production sharing agreements, and provision for an additional oil entitlement if favorable oil prices result in a rate of return in excess of specific thresholds.

As Ghana becomes more prosperous and moves to middle-income status, the structure of the country's external financing is likely to change. In particular, reduced grant and concessional financing would give way to borrowing at non-concessional terms, which is typically at shorter maturity and higher cost (in the DSA the average maturity of non-concessional borrowing is 6 years and the assumed interest rate is 8 percent). A shift to non-concessional funding would leave the debt-to-GDP ratio largely unaffected, while increasing the debt service ratios (measured relative to exports and government revenues).

In the baseline scenario, the present value of debt-to-GDP ratio benefits from a rebalancing from domestic to foreign debt, which has higher concessionality. A more balanced reduction in foreign and domestic debt would be associated with a less marked improvement in the present value of debt-to-GDP ratio and the debt service indicators. At the same time, a larger reduction in foreign debt would reduce vulnerability to exchange rate changes.

It was clear from the report that, the favourable DSA depends on successful fiscal stabilization. If the primary balance remains at projected 2009 levels (5 percent of GDP)[19] throughout the DSA, the present value of debt would rise from 59 to 109 percent of GDP. The outturn as at end-June 2010 shows a primary balance of 0.7 per cent of GDP, meaning a fiscal stabilization is not enough to achieve a favourable DSA based on the baseline assumption. The DSA is also sensitive to currency valuation, with a 30 percent depreciation raising the present value of debt-to-GDP ratio by 25 percentage points by the end of the projection period. This part of the assumption is defeated by a stable currency for the first half of 2010.

The conclusion of the report is that, Ghana remains at moderate risk of debt distress due to short- and medium-term vulnerabilities from two key factors: oil revenues and fiscal performance. Even with oil production, failure to reduce the large primary fiscal deficit and sustain this consolidation over the coming years would result in a much less favourable DSA outlook. Furthermore, the historic scenario, which reflects the looser fiscal stance in recent years, shows substantially higher debt-to-GDP and debt-service ratios, with the former quickly exceeding the threshold levels. Therefore,

19 *The actual turnout of the primary balance was only 0.6% of GDP, which is far below the baseline scenario projection*

the ability to sustain fiscal adjustment in the short term and the potential to accelerate non-oil growth in the medium term while oil revenues increase have emerged as key risks to an otherwise favourable baseline.

With regards to the use of the revenues from the oil, the report stressed the importance of developing a strategy for using the revenues in a productive manner. To assure Ghanaians of the judicious use of the oil revenues, an Act, the Petroleum Revenue Management Act, 2010 which provides the framework for the collection, allocation and management of petroleum revenue in a responsible, transparent and accountable manner for the benefit of the citizens of Ghana in accordance with Article 36 of the Constitution and for related matters, will be put before Parliament in October 2010 for consideration.

Section 6: Conclusions and recommendations

6.1 Conclusions

Ghana has come a long way in developing a securities market which has a broad investor base. The inclusion of foreigners in the non-bank holders of debt instruments has further strengthened the competition and has an impact of reducing the interest rates. Managing of the domestic debt has been a herculean task as the debt levels continued to rise throughout the study period. Post-HIPC domestic debt issuance reversed the gains chalked in the first half of the study period in the form of increased interest payments. The increase in the debt burden had been necessitated by overruns in discretionary expenditure, with the wage bill being the strongest puller.

There has been some reversals of some of the deteriorating debt indicators in the first half of 2010 like managing the structure of the domestic debt instruments from short-term towards medium and long-term. Despite these improvements, the domestic debt indicators show that the debt is unsustainable.

The conclusion from the study can be summarised as follows:

Ghana has good regulatory frameworks which have not been adhered to in the period under review.

There is lack of budgetary discipline applied to domestic debt as the Executive at times disregard the processes for incurring extra-budgetary debt.

There has been improvement in the management of the domestic debt since 2009, but reducing the debt has been an arduous task as expenditure targets in 2010 have been exceeded.

Without prudent efforts towards fiscal stabilization and increase in the primary domestic balance, the country risks debt crises despite the flow of oil revenues from 2011.

The wage bill is a major contributor to fiscal instability

Contingent liabilities continue to increase the domestic debt risk as the government influencing the pricing policies of these state-owned enterprises.

There was no evidence that increase in domestic debt reduces loanable funds, but rather it increases the interest rate making cost of borrowing for investment expensive.

The oil revenues must be well managed before it can have impact on the economy and reduce the debt burden.

6.2 Recommendations

Legal and regulatory framework

More powers and autonomy from the ministry of finance should be given to the aid and Debt management division of the ministry of finance and economic planning. Though "the Minister of Finance has the sole mandate to borrow on behalf of the Government of the Republic of Ghana. This mandate is operationally conferred on the Aid and Debt Management Division to source, administer and manage the public and quasi public debts, and to develop strategies for effective public debt management". Borrowing powers should solely be conferred to this division in consultation with the minister, thus creating a measure to curb to some extent borrowing for political advancement/gain.

Systems and procedures for Domestic Debt Management

A four tier domestic debt management system involving parliament, the domestic debt management division, the ministry of finance and civil society should be created to help objectivity in the domestic debt management process. The tier will create a procedures committee independent all the four tiers which will be responsible for creating procedures and monitor if the procedures are being followed on domestic debt management before, during and after the contraction of the debt this will also ensure coordination in domestic debt management across the agencies as all the major players would be represented in the committee.

Fiscal stabilization is the main policy that the government should adopt in order to reduce the budget deficits. However, as the budget deficit underlies the concept of fiscal sustainability, one tool available to governments to maintain control over the budget deficit, and hence ensure fiscal sustainability, is the adoption of a Fiscal Responsibility Law (FRLs), which provides an institutional framework for ensuring responsibility for inter-generational equity in fiscal management. It is recommended that the country establish fiscal rules and procedures that are clear (without any ambiguity of the proposed fiscal target), flexible and transparent. These must however be accompanied by sanctions for effective enforcement and applicable escape clauses during periods of adverse shocks. But Ghana's success with fiscal rules will ultimately depend on government's commitment to the process of fiscal discipline and strong governance structures to ensure that fiscal processes are followed through.

It is recommended that fiscal policy rules should be specified in a constitutional provision that applies to governments over successive electoral cycles, and included in the on-going constitutional review. In terms of contents, the statute should be very detailed, specifying not only the nature of the policy rules, but also detailed procedural rules governing compliance.

From a political economy perspective, fiscal rules can be instrumental in avoiding the myopic policies that result from dynamic inconsistency and/or political distortions. Broadly speaking, fiscal rules can help depoliticize the macro-economic policy framework. Observance of a current-balance rule, also called the "golden rule" can prevent a crowding-out of much-needed public investment. The budget-balance rule should be accompanied by additional limits on total government expenditures, primary (noninterest) outlays, interest payments, and/or the wage bill, in order to contain the fastest growing components of fiscal imbalance.

Government should continue with the public sector reforms and expedite the operationalisation of the single spine salary structure (SSSS) to anchor wage bills (a potential source of fiscal instability) in the country. The government has started a partial implementation of the SSSS with some initial problems. Efforts should be made to address all concerns before total implementation so that the aftermath of the Ghana Universal Salary Structure (GUSS) implementation in the late 1990's does not reoccur.

Contingent liabilities represent a potential risk and burden on the government budget and a risk to domestic debt sustainability. For instance, TORs debt converted to bonds in 2001 contributed 10 per cent of domestic debt in 2000, increased to 17.3 per cent in 2002 before reducing in the following years. The government should therefore develop a framework for recording and monitoring all contingent liabilities and also formulate and implement a policy for management of the contingent liabilities. Periodic reporting of the outstanding liabilities will also ensure transparency to the public and donor countries on the management of these debts. This will help to avoid the controversy over the true size of TOR's debt, for example, when the NDC government assumed power in 2009. There is therefore the need for more flexibility in the pricing of output of state-owned enterprises to enable them to reap the benefits of market opportunities. Government should make sure it honours all subsidies due these companies.

In managing the oil revenues, the government has to adhere strictly to the contents of the Petroleum Revenue Management Bill. Furthermore, the oil revenues should not be allowed to be used as sovereign guarantees for loans.

For the private sector, an enabling environment should be created to make establishments possible to expand markets, enhance profits, retain customers because they are better satisfied, achieve and maintain competitive advantage and ultimately growth.

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APPENDIX 1

Holders of Domestic Debt (GH¢ million)

Holders	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
A. Banking system	**585.3**	**673.9**	**919.3**	**793.2**	**1,268.5**	**1,602.6**	**2,244.7**	**2,522.1**	**3,250.5**	**4,228.7**
Bank of Ghana	302.7	273.0	339.6	268.1	595.7	695.1	1,182.1	1,371.0	1,872.1	1,766.2
Commer-cial Bank	282.6	401.0	579.7	525.1	672.7	907.5	1,062.6	1,151.1	1,378.4	2,462.5
B. Nonbank sector	**199.0**	**345.6**	**471.7**	**565.9**	**421.3**	**221.4**	**649.0**	**1,186.1**	**1,549.8**	**1,854.5**
Discount house	0.0	0.04	0.04	0.04	0.04	0.04	0.0	0.0	0.0	0.0
SSNIT	7.2	13.1	62.5	80.6	71.6	22.8	107.7	178.5	255.6	246.7
Insurance Companies	0.0	9.9	11.4	16.1	25.9	5.1	14.9	21.7	39.9	52.8
Other Holders	191.8	322.5	397.7	469.2	323.7	193.5	526.4	985.9	1,254.3	1,555.0
TOTAL (A+B)	**784.2**	**1,019.5**	**1,390.9**	**1,359.1**	**1,689.7**	**1,823.9**	**2,893.7**	**3,708.2**	**4,800.2**	**6,083.2**

APPENDIX 2

Structure of Domestic Debt (GH¢ million)

Type of Instrument	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
A.Short-Term Instruments	**501.1**	**619.4**	**820.6**	**805.2**	**710.4**	**529.9**	**793.3**	**880.2**	**1,788.4**	**2,538.9**
91-Day Treasury Bill	356.7	369.0	476.1	411.2	338.2	127.7	225.0	245.5	843.0	649.6
182-Day Treasury Bill	143.1	231.5	254.6	267.5	269.1	194.0	129.9	134.0	665.3	1,767.0
1-Year Treasury Note	1.3	18.9	89.9	126.5	103.0	208.2	438.4	500.7	280.0	122.3
B. Medium-Term Instruments										
2-Year Floating Treasury Note	0.0	0.0	0.0	0.0	0.0	264.8	138.7	40.8	7.0	0.0
2-Year Fixed Treasury Note	0.0	0.0	0.0	0.0	159.9	220.7	478.3	675.9	534.1	1,001.4
3-Year GGILBS	0.0	104.5	0.0	0.0	33.3	22.5	1.0	0.0	0.0	0.0
3-Year Floating Treasury Note	0.0	0.0	132.7	144.2	50.7	13.4	13.4	2.1	0.0	0.0
3-Year Fixed Treasury Note	0.0	0.0	0.0	0.0	11.3	27.2	151.7	646.3	752.6	627.6

Type of Instrument	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
5-Year GOG Bond	0.0	0.0	0.0	0.0	15.7	0	75.7	268.8	268.8	268.8
GOG Petroleum Finance Bond	0.0	0.0	0.0	0.0	80.0	80.0	80.0	80.0	80.0	80.0
TOR Bonds	0.0	97.9	240.0	218.2	185.5	105.5	157.4	110.0	110.0	110.0
C. Long-Term Instruments	**197.6**	**197.6**	**197.6**	**197.6**	**442.9**	**559.9**	**1,004.2**	**1,004.2**	**1,025.1**	**1,352.3**
Long Term Government Stocks	59.1	59.1	59.1	59.1	59.1	0.0	421.6	421.6	421.6	748.8
Telekon Malaysia Stock	-	0.0	0.0	0.0	0.0	64.7	87.4	87.4	109.5	109.5
Revaluation Stock	130.2	130.2	130.2	130.2	381.7	493.1	493.1	493.1	493.1	**493.1**
Other Government Stocks	8.3	8.3	8.3	8.3	2.2	2.2	2.2	2.2	1.0	**1.0**
D. Short Term Advance	**85.6**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**234.2**	**104.2**
TOTAL DEBT STOCK	**784.2**	**1,019.5**	**1,390.9**	**1,365.2**	**1,689.7**	**1,823.9**	**2,893.7**	**3,708.2**	**4,800.2**	**6,083.2**

Source: Bank of Ghana

APPENDIX 3

Summary of Ghana's Fiscal Position (GH¢ million)

ITEM	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
REVENUE & GRANTS	**538.5**	**846.3**	**1,129.1**	**1,686.2**	**2,393.8**	**2,825.6**	**3,191.8**	**4,508.2**	**5,619.7**	**6,775.2**
Domestic Revenue			976.7	1,374.3	1,899.8	2,315.6	2,556.9	3,194.7	4,018.6	4,946.5
EXPENDITURE & NET LENDING	**756.4**	**982.7**	**1,225.4**	**1,864.0**	**2,623.2**	**2,989.5**	**3,873.5**	**5,624.5**	**8,009.8**	8,248.2
Domestic Expenditure			874.4	1,211.1	1,846.2	1,985.5	3,119.4	4,056.3	5,791.8	4,921.2
OVERALL BALANCE (COMMITMENT BASIS)	**-217.9**	**-136.4**	**-96.2**	**-177.8**	**-229.4**	**-163.8**	**-681.7**	**-1,116.3**	**-2,390.1**	**-1,473.1**
ROAD ARREARS	-32.8	-4.4	-19.8	-22.3	-7.1	-9.9	-9.6	-16.0	-46.9	-75.9
NON-ROAD ARREARS	-15.6	-44.2	-61.4	-39.5	-19.9	-101.5	-31.6	-60.6	-95.4	-550.6
OVERALL BALANCE (CASH BASIS)	**-266.4**	**-187.7**	**-190.1**	**-244.5**	**-262.0**	**-286.9**	**737.1**	**-1,216.3**	**-2,558.5**	**-2,130.8**
OVERALL BALANCE (INCL. DIVESTITURE)	**-234.1**	**-166.1**	**-251.6**	**-215.5**	**-259.3**	**-196.7**	**-867.6**	**-1,132.2**	**-1,976.5**	**-2,056.2**

ITEM	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
FINANCING:	**234.1**	**166.1**	**251.6**	**215.5**	**259.3**	**196.7**	**867.6**	**1,132.2**	**1,976.5**	**2,056.2**
DOMESTIC (NET)	239.8	86.2	233.2	-22.9	39.3	-157.4	476.5	713.0	1,152.7	1,042.1
BANKING SECTOR	191.0	-72.7	103.5	-113.4	164.0	30.5	51.9	209.2	673.2	771.7
Bank of Ghana	178.8	-118.2	78.5	-50.7	21.0	-157.1	-19.9	363.6	572.3	-92.9
Commercial banks	12.2	45.5	25.1	-62.8	143.0	187.6	71.7	-154.4	100.9	864.6
NON-BANK	48.8	158.9	129.6	90.5	-124.7	-187.9	424.7	503.8	245.2	270.4
OTHERS	0.0	0.0	0.0	0.0	0.0	0.0	80.5	168.5	234.2	0.0
FOREIGN (NET)	-5.6	79.9	18.4	58.1	148.6	244.6	317.7	158.8	241.9	955.5
INFLOWS	181.1	218.9	134.5	314.1	340.6	454.5	460.1	480.0	661.8	1,413.2
Project Loans	100.9	113.4	118.5	204.3	248.6	308.0	299.4	378.2	508.5	1,082.7
Program Loans	80.2	105.6	16.0	109.7	92.0	146.5	160.7	101.9	153.3	330.5
AMORTIZATION	-186.8	-139.0	-116.0	-255.9	-192.0	-209.8	-235.1	-321.2	-497.4	-457.7
Nominal GDP	**2,715.3**	**3,807.1**	**4,886.2**	**6,615.8**	**7,988.7**	**9,726.1**	**11,672.0**	**14,045.8**	**17,451.6**	**21,746.8**

Source: Bank of Ghana, Ministry of Finance and Economic Planning, and Ghana Statistical Service

APPENDIX 4

Commercial Banks Rates (end-period)

ITEM	2001	2002	2006	2007	2008	2009
Bank of Ghana Prime Rate	**27.00**	**27.00**	**12.50**	**13.50**	**17.00**	**18.00**
Inter-Bank Weighted Average	-	-	12.56	11.98	19.03	16.51
Deposit Money Banks						
(a) Deposit Rates						
Demand Deposits	16.75	13.50	7.13	7.13	3.88	3.63
Savings Deposits	18.00	14.50	4.75	4.55	9.00	10.00
Time Deposits						
3-month	33.50	23.25	8.00	9.00	16.38	19.00
6-month	28.00	21.25	8.25	9.05	16.88	20.50
12-month	26.25	20.00	8.75	10.75	15.50	18.50
24-month	15.00	-	9.50	10.50	15.75	16.00
Certificates of Deposit	27.75	18.00	7.25	7.50	14.00	20.50
Call Money	22.50	17.25	4.75	5.25	8.50	13.75
Any other	28.00	17.00	7.25	6.50	12.55	15.92
(b) Lending Rates						
Agriculture	47.00	44.00	24.25	23.75	27.25	32.75
Export Trade	47.00	44.00	24.25	24.25	27.25	32.75
Manufacturing	47.00	44.00	24.25	24.25	27.25	32.75
Mining and Quarrying	47.00	44.00	24.25	24.25	27.25	32.75
Construction	47.00	44.00	24.25	24.25	27.25	32.75
Other Sectors	47.00	42.50	24.25	24.25	27.25	32.75
(c) Base Rates	**42.00**	**37.50**	**20.85**	**18.77**	**27.22**	**31.40**

Source: Bank of Ghana

APPENDIX 5

Money Market Rates (end-period)

Government of Ghana/ Bank of Ghana instruments	2001	2002	2006	2007	2008	2009
28-day Discount Rate	-	-	12.53	12.47	18.40	18.50
28-day Interest Rate Equivalent	-	-	12.66	12.59	18.66	18.77
56-day Discount Rate	-	-	12.50	12.50	15.25	15.25
56-day Interest Rate Equivalent	-	-	12.75	12.75	15.62	15.62
91-day Discount Rate	38.00	27.95	9.41	10.34	23.22	21.33
91-day Interest Rate Equivalent	41.99	30.05	9.65	10.61	24.65	22.53
182-day Discount Rate	-	25.25	10.00	10.25	23.15	22.46
182-day Interest Rate Equivalent	-	28.90	10.70	10.80	26.18	25.30
1-year Interest Rate	-	29.92	13.00	12.30	20.00	20.00
2-year floating Interest Rate	-	0.00	14.00	0.00	0.00	0.00
2-year Fixed Interest Rate	-	-	13.50	12.80	21.00	23.50
3-year floating Interest Rate	-	-	17.20	0.00	0.00	0.00
3-year fixed Interest Rate	-	0.00	14.00	12.08	0.00	0.00
5-year GOG Bond Interest Rate			14.47	13.67	0.00	0.00

Source: Bank of Ghana

DOMESTIC DEBT MANAGEMENT IN AFRICA THE CASE OF GHANA

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