Key Policy Initiatives for Ghana's Post-Covid Recovery

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Abstract

The Covid-19 pandemic has caused extensive disruption to Ghana's economy, with severe effects on businesses, jobs and livelihoods. The post-pandemic recovery will be arduous and protracted, and it will require well-coordinated and comprehensive policies to turn the situation around. This paper presents some policy initiatives that the IEA believes are key for immediate recovery and long-term growth. In this regard, the paper calls for: i) scaling up revenue and allocating it prudently and efficiently, especially in favour of investment spending; ii) a complementary role for monetary policy in terms of providing direct support to the economy and financial accommodation to government; iii) leveraging our natural resources to support industrialisation and post-Covid recovery; iv) developing and tapping the potential of agriculture to ensure food security and support long-term growth; and v) promoting industrialisation by leveraging our natural and agricultural resources to transform the economy.

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1. Introduction

The Covid-19 pandemic has caused extensive disruption to Ghana's economy, with severe effects on businesses, jobs and livelihoods. The post-pandemic recovery will be arduous and protracted, and it will require well-coordinated and comprehensive policies to turn the situation around. This paper presents some policy initiatives that the IEA believes are key for immediate recovery and long-term growth. In this regard, the paper calls for: i) scaling up revenue and allocating it prudently and efficiently, especially in favour of investment spending; ii) a complementary role for monetary policy in terms of providing direct support to the economy and financial accommodation to government; iii) leveraging our natural resources to support industrialisation and post-Covid recovery; iv) developing and tapping the potential of agriculture to ensure food security and support long-term growth; and v) promoting industrialisation by leveraging our natural and agricultural resources to transform the economy.

2. Fiscal Policy

Fiscal policy must necessarily lead the post-Covid recovery because it is uniquely placed to mobilise and manage the needed resources. To be able to play its role effectively, persistent lapses in both revenue and expenditure must be addressed.

Ghana has a persistent problem with revenue mobilisation. The country collects only 12-13% of its GDP in taxes. This figure compares unfavourably with an average of over 25% for middle income countries and the performance of key African peers such as Rwanda (15%), Cote d'Ivoire (18%), Kenya (18%), South Africa (28%) and Seychelles (32%) [OECD Revenue Statistics]. Ghana's tax effort also falls far short of the minimum threshold of 20% set under the proposed Eco currency system of the Economic Community of West African States. Ghana's tax performance is low in spite of having relatively high personal income and corporate tax rates. The problem, therefore, does not lie with our tax rates; it rather lies with the taxes that we fail to collect. To raise Ghana's tax effort to international standards, the problem of tax losses must be tackled head on.

The informal sector remains almost wholly outside the tax net. The sector involves relatively small-scale activities yet accounts for 27% of total national income (Ghana Statistical Service, GSS, 2019). It follows, therefore, that if the sector is effectively taxed, tax revenue will increase to some extent. However, we should be taxing the mechanics, hairdressers, tailors and other artisans who employ at least a few people, rather than the tiny fish like kayayei, kenkey, waakye and ice-water sellers, who have tiny net incomes. To ensure that adequate taxes are collected from the informal sector, it must be integrated into the tax system through formalisation. Government's initiative to digitise the economy is well-directed to bringing the informal sector into the tax net. This effort should be supplemented by leveraging new information and communication technologies, such as mobile money and other tech platforms.

Tax evasion is quite pervasive in the country. While it is difficult to quantify it, the tax revenue losses associated with evasion are believed to be substantial. In most cases, evasion results from connivance between taxpayers and tax officials. A strict surveillance system backed by a strong sanctions regime needs to be instituted to deter and minimise the incidence of tax evasion and the associated losses.

There is a high spate of tax exemptions in Ghana. They are granted to a variety of companies, NGOs, diplomatic missions, government officials and private individuals. The system is, however, subject to considerable abuse, with considerable lobbying for preferential treatment. It is estimated that annual tax revenue losses through exemptions are in excess of GHc5 billion (or nearly US$1 billion). Our authorities recognise the magnitude of the problem and have placed a bill before Parliament to address it. The political will to pass the bill has, however, been lacking. This appears to be due entrenched interests of the political class, many of whom are beneficiaries of the exemptions. We urge Parliament to pass the bill as a matter of urgency to plug a big hole in the tax system.

Illicit financial flows are known to be pervasive in Ghana. They include trade mis-invoicing, transfer pricing and various forms of money laundering. These underground dealings cause the nation huge amounts in tax losses. Studies by our development partners and others put revenue losses from illicit financial flows at about US$3-4 billion annually. We need a strong, investigative, surveillance system to detect and curb these practices. A strong sanctions regime is also needed to punish and deter culprits.

Property taxes are barely collected in Ghana. The spate of sprawling mansions in the urban areas testifies to the potential of property taxes. It appears that the reluctance to collect property taxes is driven by a propensity to protect the upper class and politically connected people who own the mansions. It is not even clear whether it is the responsibility of central government or local governments. We suggest that property tax collection should be clearly made the responsibility of Metropolitan, Municipal and District Assemblies. They should be incentivised to collect and retain part as internally generated funds and should be authorised to use those funds at their discretion to finance their development projects.

Fraud and corruption are rampant in Ghana's tax system. This is perpetrated through connivance between taxpayers and tax officials to underestimate payable taxes, with the state being short-changed as a result. The pervasive human-human interface in the tax system serves as an incentive for these practices. Abating tax fraud and corruption will require a strong, multi-layered surveillance system supported by automation and digitisation. There is also a need for a strong sanctions regime to deter and punish offenders.

Despite efforts over the years to improve tax administration, inefficiencies still persist. These relate to timeliness, coverage and costs, among others. It will be necessary to continue with reforms to reduce inefficiencies further. Expanding automation and digitisation would go a long way to improve efficiency in tax administration.

Experts conservatively estimate Ghana's tax losses through the foregoing loopholes at around 10-12% of GDP. Set against our current tax/GDP ratio of 12-13%, it means that we lose about as much tax revenue as we collect. The need to plug the loopholes cannot, therefore, be stressed enough. The authorities should take the need to scale up our tax revenue effort seriously since that is the only way we can fund the many projects and programmes required for the immediate post-pandemic recovery and long-term growth. If we continue to tinker with our current tax revenue effort and only aim at making small incremental changes, as our medium-term budgetary projections seem to imply, then we are not going to make much progress in the development of the economy.

While mobilising adequate revenue is critical for post-Covid recovery, the utilisation of the revenue is equally important. Government expenditure has long been plagued by two key problems. The first is that expenditure is constrained by the low revenue effort and the second is that expenditure is overstretched. Ghana's expenditure/GDP ratio is about 21-22%. This is not too high when compared to the middle-income average of about 35%. Ghana's expenditure is relatively low because it cannot exceed revenue by a large margin since it would take an equally high level of borrowing to fund the excess, leading to an unsustainable debt situation. But even more worrying is that the pro-growth capital component of expenditure has borne the brunt of the constrained expenditure. At less than 5% of GDP in recent years, Ghana's capital expenditure/GDP is very low by international standards. Indeed, developing countries need to invest not less than 15% of their national income to spur their growth. One of the Eco zone convergence criteria is that public investment/tax revenue should not be less than 20%. In 2019, Ghana invested about 14% of its tax revenue, significantly less than the Eco zone target. Apart from expenditure being constrained by the low revenue effort, it is also overburdened by excessive earmarking. We have a situation where earmarked spending in the form of wages, debt service and payments to statutory funds – GETFund, District Assemblies Common Fund (DACF), Road Fund and National Health Insurance Fund (NHIF) – have surpassed total revenue. This means that the remaining expenditure on goods and services and capital have to be financed from borrowing. And in an effort to contain the deficit and borrowing, capital expenditure, which is needed for growth, has had to be sacrificed. Obviously, we need to tidy up the expenditure side of the budget as well, otherwise revenue will be inefficiently disbursed.

We start from the public sector wage bill. In 2019, the wage bill amounted to 5.0% of GDP and used up 47% of tax revenue. These figures represent an unsustainable situation that needs to be remedied. The solution is to reform the public sector through downsizing and measures to improve efficiency and productivity of the sector. Unfortunately, public sector reforms have been shelved for far too long due to the lack of political will to implement them. But we cannot continue to ignore the problem; and this is the time to act so that the excessive expenditure on the sector can be contained, thereby freeing up resources to undertake more critical spending.

Payments to statutory funds have become an increasing burden on the government budget. Efficiency in the management of these funds has, however, been called into question by various studies (IFS: 2016, 2017). It is about time to take a critical look at these funds with a view to reforming them to improve their efficiency and make them more fit for purpose. The reforms should include streamlining and aligning the funds more closely with the central government capital budget. These reforms should be carried out urgently to prevent the funds from totally overwhelming the budget.

Debt servicing has become a major burden on the budget. Because of increasing borrowing to finance budget deficits, interest payments have grown to unsustainable levels. In 2019, interest payments amounted to 4.9% of GDP and used up 46% of tax revenue. If you have to use almost half of your tax revenue to service debt, then you are in a real bad situation. It would require a comprehensive debt management strategy to bring such a situation under control. The strategy should include debt restructuring and refinancing (or re-profiling) to lengthen the maturity profile and ease repayment terms. Consideration should also be given to debt buybacks to reduce the overall size of the debt. But the bottom line for reducing debt service over the long haul is to curtail the budget deficit and associated borrowing. The measures we are advocating to raise more revenue and streamline and rationalise expenditure are meant to do exactly that. They should, therefore, receive the serious attention of the authorities.

Expenditure on goods and services has been growing in line with an expanding public sector. In 2019, that line item used up 16.3% of tax revenue. Relative to the big-ticket items like wages and interest payments, this may look small. But it is not insignificant, and it is likely to grow with the growing size of the public sector. Moreover, spending on goods and services, which include travel, entertainment, general administration and maintenance, are often subject to considerable abuse and waste. It is, therefore, important to call for such spending to be controlled through appropriate streamlining and rationalisation as well as effective oversight.

Capital expenditure (CAPEX) has been squeezed over the years, bearing the brunt of inadequate revenue and competing spending interests. In 2019, CAPEX was as low as 2.8% of GDP. Such level of investment spending is inimical to long-term growth of the economy and should not continue. It is important to scale up CAPEX significantly by implementing the revenue-enhancement and expenditure-rationalisation measures suggested above.

We recognise the steps taken in recent years to build structures to strengthen fiscal policy, including the passage of the Public Financial Management and the Fiscal Responsibility Acts. However, these efforts in and of themselves cannot be successful unless the underlying weaknesses in both revenue and expenditure that we have outlined above, and which perpetuate the gap between the two, are addressed.

3. Monetary Policy

Monetary policy must play a complementary role in the recovery effort. While price stability is the primary objective of monetary policy, the central bank is also enjoined "to support the general economic policy of Government, economic growth and development" (BoG Act (2002), Act 612). Through the early 1980s, the central bank exercised this broad mandate by providing direct support to the economy, including through financing of development projects, creating a regime of low interest rates and directing lending to strategic sectors like agriculture and industry. However, following the country's adoption of economic liberalisation measures starting from 1983, the bank abandoned its developmental role. As a central bank in a developing country, the bank needs to go beyond its narrow price-stability mandate to support the development of the economy. And this support is most needed for the post-pandemic recovery.

The central bank should as a matter of priority reactivate its development finance function. This it can do either by creating a department within the bank or supporting a separate development finance institution outside the bank. It has to be emphasised that a central bank in a developing country has a responsibility to support development directly. One key area that the bank can offer direct support to the economy is the food buffer stock system, given the high incidence of post-harvest losses in the country. The bank has been involved somewhat in this scheme recently, and we urge it to continue that role and even scale it up.

One major worrying factor in Ghana's financial system has been the prevalence of prohibitively high interest rates. SMEs and key sectors like agriculture and manufacturing, in particular, have borne the brunt of such high lending rates. The recovery of the economy requires that interest rates are made generally affordable, especially for sectors deemed strategic in the economy. The central bank can make credit affordable to such sectors by subsidising lending by targeted institutions to those sectors. The bank must also reinforce its regulation of the financial sector and ensure that banks charge reasonable rates for their services, while also following closely interest rate trends dictated by monetary policy.

Availability of financial resources to government will be critical for the recovery. That is the very reason we have called for a strong revenue mobilising effort. But government, inevitably, will have to borrow to supplement its revenue, even when it has succeeded in scaling it up. For a couple of years now, government has refrained from borrowing directly from the central bank to finance the budget so as to limit its inflationary impact. The alternative has been for government to borrow at much higher rates from the domestic bond market, where it crowds out the private sector, or from international markets, increasing the external indebtedness with potential future reverse outflow of foreign exchange. Given the exigencies of the time, the central bank should restore government's access to its financing, subject to an agreed cap. This will allow government to obtain cheaper and more convenient supplementary funds to support the recovery.

4. Natural Resource Policy

Our natural resources represent the low hanging fruits for mobilising funds to support the recovery and long-term growth. Ghana has untapped natural resource wealth in the form of oil, gas, gold, manganese, bauxite and iron ore, among other resources, that is estimated to be worth over US$12 trillion. It is inconceivable, therefore, that while we have such riches below ground, there is equally plentiful poverty above ground. This situation is the result of our failure to exploit our natural resource wealth prudently and to use it to transform the economy through industrialisation. For decades, our minerals have been mined by foreign companies that have been offered generous concessions, including disproportionate shares of the minerals, liberal tax rates and export retention rights. The result of these lavish concessions has been the impoverishment of our economy and mining communities. When we discovered oil in 2007 and started commercial production in 2010, it was thought that we would learn from the mistakes of the defective mineral fiscal regimes. Unfortunately, we have been repeating the same folly of signing concession contracts whereby investors are given ownership of oil blocks while Ghana barely benefits from meagre royalties, taxes and carried and participatory interest. Since the onset of oil production, Ghana's share of the total output is estimated at about 15% and valued around U$5 billion. This means that foreign oil companies have pocketed 85% or nearly US$30 billion of the total proceeds. How can this be justified?

Concession contracts only serve the interest of the foreign investor—and their few Ghanaian cohorts. However, they are bad for Ghana—and must stop! Even as far as oil and gas resources are concerned, concession contracts are against the Petroleum Exploration and Production Act, 2016 (Act 919), which requires contracts to be signed on product-sharing basis. This is where Ghana and the investor agree on a formula to share the output without the investor being offered any concessions. All contracts signed on concession basis are, therefore, in breach of the law and, as such, voidable. These must be subject for legal action. Other countries have even moved beyond product-sharing contracts to "service contracts" whereby the investor is paid for the cost of extracting the oil plus a profit margin rather than receiving a share of the physical product. This is where Ghana should be aspiring to ultimately.

We should ensure that Ghana receive maximum benefits under contracts signed with foreign investors to exploit our resources. We should refrain from signing any new contracts on a concession basis. The unjust fiscal regimes deprive the country of huge amounts of resources that could otherwise have been used to support national development. The mining communities, in particular, have borne the brunt of environmental degradation associated with mining activities and the populations remain impoverished. Other natural resource-endowed countries have managed to negotiate far better fiscal regimes. And Ghana must learn from best practice. We should revisit our mining contracts, where possible, and renegotiate the export retention and other generous terms granted foreign investors. Indeed, if you aggregate the benefits that accrue to investors under our mining fiscal regimes, what accrues to Ghana is really minimal. Our gross domestic product and balance of payments figures tend to be woefully overstated since we include the benefits that accrue to foreign investors. Stripped of the benefits to investors to arrive at (net) domestic product and (net) balance of payments, the true figures, including the all-important per capita income measure that determines our relative richness on a global scale, would look very modest indeed. This anomaly supports the need for us to take ownership of our mining sector and ensure that the contracts deliver maximum benefits to Ghanaians.

As a country, we should use what we have to achieve what we want. This is the principle David Ricardo espoused in the 19th Century in his "Theory of Comparative Advantage." Indeed, Nkrumah embarked precisely on a path to exploit our gold, bauxite, manganese iron ore and water resources to support industrialisation and development. We must return to this strategy and exploit our natural resources to the fullest, albeit in a sustainable way, to spur our development. We should not exploit our natural resources and merely export them in their raw state as we have been doing during our entire history. If you read Ricardo well, this is not what he advocated. He rather advocated that we utilise our comparative advantage in resources to produce other goods more competitively. We will have a lot more to say on the need to link our natural resources to industrialisation of the economy in Section 6.

5. Agricultural Policy

We cannot have a durable recovery and sustained long-term growth without tapping the potential of our agriculture, which remains the bedrock of the economy. Ghana is still predominantly an agrarian economy, with agriculture employing over 60% of the labour force and contributing about 19% of GDP I 2019 (GSS, 2019). Agriculture's contribution to GDP has fallen progressively from 45% in 1990 to 19% currently. In the course of a country's development, it is normal for agriculture's contribution to GDP to decline, as increasing productivity allows excess labour and other resources tied to the sector to be released into other economic activities. That is how countries evolve from primary agrarian to secondary industrial and tertiary services economies. In the Ghanaian situation, however, the decrease in agriculture's contribution to GDP over the years has been driven largely by declining or stagnating productivity, which is not desirable. We still lack food affordability and security for all. The fact that food accounts for 43% of the average Ghanaian's monthly spending, while millions of Ghanaians cannot afford two square meals a day, suggests that agriculture still faces serious challenges. Agricultural productivity can be enhanced by supporting peasant farmers with irrigation facilities, high-yielding seed varieties, fertilizer and quality extension services. At the same time, steps should be taken to promote large-scale commercial agriculture capable of leveraging modern equipment and farming methods.

It is important to develop the entire value chain in agriculture from production to storage to processing to marketing. We recognise that government's agricultural policy initiatives—Planting and Rearing for Food and Jobs, One Village One Dam and One District One Warehouse—represent elements of such a value chain. It has to be emphasized that the post-production management of food is as important as the production itself if availability all year round is to be ensured. We see too many instances of abundant farm produce in peak seasons going to waste because of lack of storage and markets. This is not only wasteful but a clear disincentive to farmers. The National Food and Buffer Stock Company is an important scheme in extending the life span of crops and it should be fully supported. Also, ensuring adequate transportation infrastructure and marketing facilities is critical to reduce the usual large mark-ups of retail prices over farm-gate prices. Further, agriculture requires special support in the form of cheap credit facilities. This is where Government and the Central Bank should team up to provide subsidised credit facilities to the sector through a designated agricultural finance institution. Left to the dictates of the free market, the financing of agriculture would be ignored since it is regarded as a risky activity.

Finally, as we elaborate in Section 6, agriculture should be closely linked to industry, supplying it the necessary inputs. We know that one snag with Nkrumah's industrialisation programme was the lack of adequate raw materials to feed the industries he established. In the end, raw materials had to be imported at considerable and unsustainable cost. This is a lesson that should not be repeated. We must ensure availability of adequate supply of local raw materials to feed industries.

6. Industrial Policy

Industrialisation is a key propeller of economic growth. The Industrial Revolution that started in the mid-19th century, catapulted the United States and Europe into first-world status within a generation, while other countries untouched by the revolution lagged behind. Unfortunately, Ghana is less industrialised today than it was in 1970, with manufacturing output as a ratio of GDP dropping by about a third from 15% to 10%. The "de-industrialisation" of the country in the past 50 years has retarded growth of the economy and growth in living standards. The need to reverse these negative trends has become more imperative. As noted above, we have comparative advantage in natural and agricultural resources and this should be leveraged to spur industrialisation and economic transformation. As Ricardo proffered, our comparative advantage in these resources should inform the kind of industries in which we would have competitive advantage as well. Nkrumah established a wide range of industries, some of which relied on our natural and agricultural resources, whereas others did not. We also know that his industrialisation strategy was state-driven. However, Nkrumah's important industrialisation blueprint was curtailed after his overthrow and the subsequent adoption of privatisation policies in the context of extensive liberalisation of the economy.

We wish to emphasise, in particular, the need to link industrialisation to our agricultural resources so as to maximise the value of the latter. Our huge arable land has allowed us to acquire comparative advantage in agricultural products like cocoa, palm, rubber and wide-ranging food items, which can feed industries to produce consumables for the local and international markets. For, example, we have long paid lip service about processing and adding value to our cocoa before exporting it, but have made limited progress in that regard. Meanwhile, the total global raw cocoa market is estimated at US$10 billion, whereas the chocolate market is worth ten times as much at US$100 billion. Why we continue to export cocoa in its raw form in the quest for part of the meagre US$10 and do not target the larger US$100 billion market beats the imagination.

We take note of Government's One District One Factory (1D1F) industrialisation strategy. We believed that the 1D1F strategy should be informed by our industrialisation experience and international best practice. It is important to ensure that the planned factories are appropriately linked to our natural resource supplies to ensure their competitiveness and sustainability. In addition to the supply chain and product-type considerations, care should also be taken in deciding about factory sizes, locations, ownership and management structures. Some have argued that dotting factories all over the country may not be the best industrialisation model. More successful countries like China, South Korea, Malaysia and Thailand are known to have created large industrial parks comprising strategic industrial conglomerates so that industries could benefit from contagion in terms of technology transfer and economies of scale. Silicon Valley in the US, for example, created a magnet for the conglomeration of the best technology companies in the world. May be, we can learn useful lessons from this blueprint.

We also believe that, like the experiences of the successful countries mentioned above, the state must lead and drive the industrialisation process. The curtailment of Nkrumah's state-led industrialisation strategy and subsequent privatisation of most of his industries, contributed to the de-industrialisation of the country, which has set us back decades on the path to economic progress. We cannot rely on the free market and private enterprise to drive our industrialisation—at least not in the initial stages. We do not suggest that the private sector should be completely ignored in this process. The sector can play a supplementary role. In particular, we believe that small and informal sector industries should be nurtured and supported to grow and flourish. This government can do by creating the necessary enabling environment, including an easy regulatory framework, good infrastructure, stable markets, favourable trade policies, R & D support and a stable macroeconomic environment.

7. Conclusion

The Covid-19 pandemic has caused extensive disruption to Ghana's economy. It will take well-coordinated and comprehensive policies to spur the immediate recovery and sustain growth over the long term. This paper has provided some of the key policy initiatives for achieving these results. These initiatives are summarised as follows:

- Fiscal policy must lead the recovery. To this end, fiscal policy should raise the needed revenue by plugging numerous leakages in the tax system. Expenditure should be reformed to reduce the excessive earmarking and scale up pro-growth CAPEX.
- Monetary policy should provide direct support to the recovery. The central bank should ensure that affordable credit is made available to priority projects and sectors, while also providing financial accommodation to Government, as needed.
- Ghana's natural resources should be leveraged optimally to support the recovery and long-term growth. This requires that exploitation of the resources should be based on fiscal regimes that provide maximum benefits to Ghana.
- As the bedrock of the economy, agriculture's potential should be harnessed to ensure affordable and adequate food all year round. Agricultural resources should also be used to support industrialisation.

- Industrialisation is pivotal to the immediate recovery and long-term transformation of the economy. Ghana's comparative advantage in natural and agricultural resources should be leveraged to support industrialisation and rapid development of the economy.

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