



*Neue Wege in der Entwicklungszusammenarbeit: Budgethilfe als effektiver Beitrag and die Millenniums-Entwicklungsziele?*  
*Nouvelles voies pour la collaboration au développement :L'aide budgétaire – une contribution efficace aux Objectifs du Millénaire ?*  
*New Paths for Development Cooperation: Budget Support as an Efficient Contribution to the Millennium Development Goals?*

## ***Budget Support as an instrument to improve the business environment, first experiences and future priorities***

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### **1 Braving the storm**

In September 1999, our local bank agreed to enter negotiations with our company for a loan of US\$ 600'000, which we had applied for, to conclude the financing of a new expansion of our stone quarry. This amount was the equivalent of 1.8 billion cedis, with an exchange rate of 3000 cedis to the dollar. The loan was granted in February 2000, but by that time, the exchange rate had risen to about 7000 cedis to the dollar. Most of the equipment, for which the money was to be used, was to be imported. The bank indicated that they were in no position to give the equivalent of 4.2 billion cedis. It therefore became a take it or leave it situation. We decided to take that loan of 1.8 billion cedis, and till today, we, as an extractive company, are suffering under the negative effects of that episode.

Ghana has gone through severe macroeconomic turbulences since Independence in 1957, leading to the prescription of various policy measures including ERP and SAP in the nineties, but these could not correct the situation. By the end of the year 2000, the economy had practically come to a standstill. An excessive fiscal expansion for the presidential and parliamentary elections in that year, had lead to a spiralling inflation and currency depreciation, unfortunately coinciding with a sharp deterioration in commodity terms of trade. Within one year ending December 2000, the cedi had virtually collapsed, losing more than 50% of its value against the US dollar. Inflation was about 41%, fiscal deficit had increased from 6% of GDP in 1999 to 9%; external public debt stood at 131% of GDP, whilst domestic public debt stood at 35%. For 1999 and 2000, servicing of external and domestic debt accounted for 32% and 39% of government expenditure. In 2000, external debt alone was about US\$422 million or 24% of total government expenditure. The debt overhang led to a stifling of economic growth as well as a reduction in the provision of social services. Poor people and the vulnerable were hardest hit by this situation.

By the end of 2000, **the business community was yearning for a change in the economic management of the country.**

At the end of 2000, Ghana had elections that was won by the NPP under J.A. Kuffour, thus ending an almost 20 years rule of the Rawlings Regime. The basic tenets on which the NPP

fought those elections were freedom of the press, the rule of law, and economic liberalization; the slogan was '**positive change**'.

The major task that faced the new government was to introduce appropriate policies to reduce the debt burden and its impact on foreign earnings and social spending, to bring inflation down and lower interest rates, to improve the international reserves and balance of payment position. Also important was the realization that the public expenditure management and control needed to be strengthened.

## **2 Reconstructing the economy**

The political and economic environment in Ghana has improved greatly, albeit the trickling down has not yet taken place. One cannot lose sight of the fact that:

- Inflation has reduced from a peak of 41.5% in March 2001 to around 15% by the end of 2005, despite the fact that Ghana is an oil importing country.
- Interest rate has reduced from about 50% in 2000 to about 27% in 2005.
- The exchange rate of the cedi has stabilized around 9000 cedis to the dollar for the past 4 years.
- Private investment as percentage of GDP has increased from 13.8% in 2001 to 17.1% by the end of 2004. Public investment has also risen to 12.5% by 2004.

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Remittances					882	1384	1774	2758
Inflation	15.7	13.8	40.5	21.3	15.2	23.6	11.8	13.5
Exchange Rate	2346	3501	6889	7255	7932	8697	9004	9131
GDP Growth (%)	3.7	4.4	3.7	4.2	4.5	5.2	5.8	5.9
Gross Int. Reserves (\$m)				364.8	640.4	1425.6	1732	1929.5

*(MoFEP, Budget Statement 2006)*

- Ghana has a B+ rating from Standard and Poors and Fitch since 2004, comparable to those of Brazil, Turkey and Indonesia.
- From a low of 0.9 months in 2000, Ghana's international reserves could cover up to 3 months of imports in 2005.
- The Global Competitiveness Report 2005-2006 considers Ghana as one of the more notable successes, having moved from 71st position in 2003 to 68th in 2004, and further to 59th in 2005. Sub-Saharan countries ahead of Ghana are only South Africa (42nd), Botswana (48th) and Mauritius (52nd).

The first obvious bold policy taken by the new Government to tackle the bad situation was the decision to opt for the HIPC debt relief initiative in March 2001. This initiative was conditioned on well-disciplined macroeconomic policies.

Ghana is one of the first countries to reach the completion point under the HIPC debt cancellation programme.

The discussions on whether or not to accept the HIPC Initiative had been ongoing long before the elections in December 2000, but the NDC Government under Rawlings had refused to accept it, without offering any other viable alternative.

In fact, Ghana has also been chosen by the USA as one of the countries, under a very stringent set of criteria, to enjoy from the Millennium Challenge Account.

The nominal exchange of the cedi, for example, depreciated by 0.4% against the US dollar, but appreciated by 8.2% and 11.6% against the pound sterling and euro respectively between January and September 2005.

The Ghana Stock Exchange has also been posting gains for some years. For example, in 2003, the performance of the Exchange topped the world with 154.7% (or 142.7% in dollar terms).

Despite all these successes, the perennial 'Verteilungskampf' has not abated, usually with the health service workers beginning the strikes and youth unemployment, for example, is still high.

For the business sector, doing business in Ghana today is far better than before. The striking difference between now and then is that **planning is now possible**, because the political and economic environment is relatively predictable.

### **3 The role of GPRS and GBS**

The multi-donor budget support (MDBS), as the GBS is generally called in Ghana, in conjunction with the HIPC debt relief, has in no small way contributed to the success that the macro-economic management has achieved in the last few years.

According to figures from the Ministry of Finance and Economic Planning (MoFEP), total contributions under the MDBS was US\$218 million, out of which US\$123 million was a loan from the World Bank, and another US\$7 million from Germany; the rest were grants (Budget p.58).

The main importance of the Multi-donor budget support lies in the **improved cooperation and partnership** that it has brought between the Government of Ghana, the donors and the NGOs.

The GPRS and the GBS have brought with them a **certain high level of communication** between the partners, and this is very relevant for the development process.

The **macroeconomic discipline** that the GBS discussions as well as the HIPC conditionalities have instilled in the Ghana Government is another factor that is very relevant.

On the social front, the **number of children enrolling in schools has increased**, after physical infrastructure had been improved and the introduction of a meal a day in some schools in vulnerable areas. The Government has also introduced a that is operated by the District Assemblies. Although still not enough, the pension received by the retired people has also been increased.

For the business community, especially for my companies, **the discipline the HIPC/GBS has instilled in the Government give us the confidence which we need to make long-term decisions**, even when the going is not easy at the moment.

The fact that many multinational companies, including Nestle and Boeing, have decided to put the West African regional headquarters in Ghana shows that the Government is on the right path. In the case of Nestle, for example, the headquarters in Ghana caters for 23 countries. So to choose Ghana out of 23 countries shows that Ghana has some comparative advantages, including economic, social and political stability.

#### **4 The challenges facing governments and partners**

In 2005, Agriculture still contributed 41.4%, Industry 23.9% and Services 27.7% of GDP. Over 50% of the population is employed in the agricultural sector. It is also a fact that the majority of the poor and vulnerable has low education, and mostly engaged in the agricultural sector. The question that therefore arises is: What measures can be undertaken to educate and empower the vulnerable, especially if poverty alleviation is the focus of the GPRS?

One can identify several challenges that face both the Government and Donors:

First of all, we have to ensure that Ghana does not fall into the debt trap again.

Several measures have already been undertaken by the Government in this regard: strengthening the Aid and Debt Management Unit of the Ministry of Finance, passing of several bills including the Public Procurement Act, so as to ensure judicious use of resources, as well as increasing the revenues that come to the Government. The Government's strategy towards foreign inflows has been to:

- continue to maintain debt at sustainable levels;
- maintain the acquisition of loans at concessionary rate with a minimum grant element of 35%;
- seek more grant financing;
- seek more programme aid to support the implementation of the budget; and
- continue to implement measures to minimize the cost of external borrowing such as the margin of risk on variable rate lending and the insurance premium on export credit facilities.

Total revenue as percent of GDP, for example, has increased from 18.1% in 2001 to 24.9% in 2005. **Tax revenue has also increased** from 17.2% to 21.4% during the same period. This is remarkable, since generally, the tax rates have rather been reduced for all income brackets. It is also the policy of the Government to widen the tax net.

Secondly, how do we achieve the target of \$1000 per capita by 2015 as envisaged by the Government, when currently, it is around \$450?

Agriculture based industries remain the main focus of Government for poverty alleviation.

The main goal of the GPRS is to ensure **sustainable growth, accelerated poverty reduction and the protection of the vulnerable and excluded within a decentralized democratic environment.** (GPRS Volume 1, p.44)

The basic challenge, therefore, is how to **attract more capital** into the country, whilst maintaining the democratic environment.

Within this context, the GBS becomes relevant, since domestically financed investment, for example for 2006, covers only 22% of total Government investment. GBS funding is mainly responsible for new investments in health care, education, roads and energy.

Whilst these are relevant, it is **the provision of permanent jobs** that will help eradicate poverty in Ghana, and this is where the private sector also becomes relevant.

Therefore, GBS should also aim at encouraging foreign direct investment in Ghana. Only then can a sustained flow of GBS be guaranteed.

In the short-term, the obvious and cheapest source of capital into the country is to attract capital from Ghanaians abroad. When one looks at the more than fivefold increase in **remittances** between 2000 and 2005, then one can conclude that there is much potential to be tapped. The figure has increased from less than US\$500 million in 2000 to an estimated US\$2760 million in 2005.

For the private sector to make maximum use of any capital inflows into the country, two issues need to be tackled: first of all, the cost of borrowing locally needs to come down. Secondly, the delays in receiving payment from the Government should be eliminated. Although the cost of borrowing has reduced from 50% in 2000 to about 27% in 2005, it is still too high. Added to the high interest rates are the delays of more than six months before payments for executed jobs are made. This means that although the nominal interest rate may be 27%, the actual rate is far higher, when penalties and the opportunity costs are taken into consideration.

Within this context, some of the policy objectives and their MDBS need to be looked at. For example, the MDBS trigger for the Policy Objective of enhancing **Private Sector Competitiveness** is to further reduce the time for registering businesses. Whereas the rationale for the choice of this MDBS trigger may be the ease in acquiring this data, it may not be this best option to judge private sector competitiveness. For example, the **comparison of salary levels or credits to a particular sector** would have been better options.

For a long time, cocoa, which has been the main export commodity of the country, has been exported in its raw form. It is now the policy of the NPP Government to promote the processing of at least 50% in the country.

The Government has also introduced what is known as the **President's Special Initiatives (PSI)**, which seek to diversify Ghana's export base and exploit external market opportunities, generate skills, employment and incomes. Four of such PSIs have been launched: **oil palm, cassava starch, salt and garments and textiles**.

The Government is also open to discuss the so-called Public-Private Participation (PPP) in the provision of basic infrastructure. Currently, discussions are ongoing for the provision of energy, road and railway transport. These areas are to support the agro-based industrialization of the country.

Our confidence in the Ghanaian economy is further shown in the fact that we are involved in one of the discussions with the Government for a PPP project.

The Government could use GBS to facilitate feasibility studies in potentially viable areas.

In a study conducted by Asafu-Adjaye (2005), it was concluded that in the short-run, foreign direct investment, financial development and trade openness had no significant effect on economic growth in Ghana. In the long-run, however, these determinants have a significant effect on economic growth. It is argued that improving the enabling environment for both domestic and foreign investors seem to be a better policy option than devising incentive packages for specific firms or projects.

Aryeetey (1996) also argues that the informal sector also holds the potential for expanded economic activity and employment in Ghana.

For any capital inflows to help in the poverty alleviation, it is important that a bigger proportion of any added value, are reinvested in the country for some time.

## **5 The targets and the indicators**

Apart from the high dollar value of their production, middle- income countries are characterized by the following (GPRS II, p.20 ff.):

- They have achieved international competitiveness in one or multiple aspects of global trade in goods and services;
- They are supported by a significant level of scientific autonomy;
- They have attained a critical mass in economic propulsion, with high rates of savings and investments, and the ability to tap into the worldwide pools of equity and loan capital.

GPRS aims to achieve a growth target of 6-8% per annum, firmly situated within the perspective of changing the existing structure of production for a vibrant technological progress.

The assumptions that form the basis of the growth target include:

- Population growth rate not exceeding 2.6%,
- Single digit inflation,
- A stable cedi/US dollar exchange rate,
- Reduced interest rate on investment loans,
- Containment of fiscal deficit,
- An aggressive domestic revenue mobilization,
- Reprioritization of expenditure in favour of development expenditure,
- Growth in aggregate investment.

In order to achieve the growth target of 8%, Government is expected to pursue the right macroeconomic policies, provide the requisite incentive structures, and other input requirements. These measures are to support the private sector that is seen as the engine of wealth creation and poverty reduction.

Economic growth and transformation is expected to be propelled by the agricultural sector for the following reasons:

- Agriculture is the highest contributor to GDP;
- The bulk of the poor, especially women, are engaged in the agricultural sector;
- Increased productivity in agriculture will ensure food security;
- Modernized agriculture will prepare the ground for structural transformation between agriculture and industry;
- Creating avenues for youth employment in agriculture related businesses.

The Millenium Challenge Account is also to be utilized to mechanize agriculture.

Almost all Governments in Ghana, since Independence, have made agriculture a priority area. The question to ask therefore is what is so different under the GPRS?

Even assuming that the agriculture led growth is successful, what will happen to the masses that are going to be redundant due to the productivity increment within the sector?

The question as to the equitable distribution of the productivity gains is also not answered.

The Government also accepts that agricultural production in Ghana has remained rain-fed, and it will take some time to implement strategies such as irrigation.

**But even now, a large proportion of the farm products are wasted because of inaccessibility to markets.**

Therefore the priority should be on how to assist in the processing of farm products. In other words, it is not agriculture that should lead, but rather industrialization based on those areas where Ghana has a competitive advantage.

Within this context, the strategy of processing 50% of the cocoa produced in Ghana, as well as the cassava starch factories, are welcome.

These strategies could be adapted to maize, groundnuts, shea butter and other products.

Another important aspect is the possibility of training people for export. The growth of remittances to Ghana show that with the appropriate strategies, **export of brain and manpower** could be more profitable to the nation.

## **6 Conclusions**

Between 1999 and the end of 2000, external debt service of Ghana was around US\$422 million annually. Coupled with a politically motivated fiscal expansion, the cedi and the overall economy virtually collapsed. The result for the private sector was indebtedness and the inability to meet business targets, loss of jobs, impoverishment and loss of confidence.

With the inception of the GBS and the HIPC debt relief, initiated by a new political administration, the pressure on foreign exchange demand has reduced. The evidence is the consistent growth in the gross international reserves from US\$365 million in 2001 to US\$1930 million in 2005. Fiscal discipline has also led to a reduction in the crowding out, although interest rates still remain relatively high. The struggle for a bigger portion of the national cake is also prevalent.

The challenge facing the Government and the donor community, through the GBS, therefore, is how to navigate through the turbulent times ahead, and still maintain the fiscal discipline.

Most important for the business community will be measures to reduce the cost of borrowing and timely payment for jobs executed for the Government. Strategies to increase the constant flow of remittances from Ghanaians abroad are also welcome.

As our own experiences have shown, private companies can run into difficulties due to decisions of the Government in power. It is therefore prudent that the GBS is directed towards the Government, to help improve the environment for the business community. After all, many of the initiatives of the Government have to be implemented by the business community.

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