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EBS/89/195
Correction 1

CONFIDENTIAL

November 13, 1989

To: Members of the Executive Board

From: The Secretary

Subject: Ghana - Staff Report for the 1989 Article IV Consultation
and Request for the Second Annual Arrangement Under the
Enhanced Structural Adjustment Facility

The following corrections have been made in EBS/89/195 (10/13/89):

Page 4, line 2: for "Tables 2-10," read "Tables 2-9,"

Page 37, last line: for "in Table 10." read "in Appendix I."

Page 38, para. 3, penultimate line: for "in Table 10" read "in Appendix I"

Page 39, 1st full para., line 3: for "in Table 10." read "in Appendix I."

Corrected pages are attached.

Att: (4)

Table 1. Ghana: Fund Position During Period of ESAP Arrangement

	Outstanding at Sept. 30, 1989	1989			1990			1991		
		Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept.	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept.	Oct.-Dec.
<u>(In millions of SDRs)</u>										
Transactions under tranche policies (net)	--	-31.11	-10.88	-33.33	-7.13	-29.75	-3.92	-26.21	-3.92	-22.33
Purchases	--	--	--	--	--	--	--	--	--	--
Ordinary resources	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Enlarged access resources	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Repurchases	--	31.11	10.88	33.33	7.13	29.75	3.92	26.21	3.92	22.33
Ordinary resources	(--)	(8.56)	(6.68)	(6.68)	(2.93)	(1.06)	(--)	(--)	(--)	(--)
Enlarged access resources	(--)	(22.55)	(4.20)	(26.64)	(4.20)	(28.69)	(3.92)	(26.21)	(3.92)	(22.33)
Transactions under special facilities (net) 1/	--	-7.28	--	--	--	--	--	--	--	--
Purchases	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Repurchases	(--)	(7.28)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Structural adjustment facility loans	--	--	--	--	--	--	--	--	--	--
Enhanced structural adjustment facility loans	--	87.00	--	48.00	--	48.00	--	48.00	--	--
Total Fund credit outstanding (end of period) 2/	509.58	558.18	547.31	561.98	554.85	573.10	569.18	590.97	587.05	564.72
Tranche policies	324.30	293.18	282.31	248.98	241.85	212.10	208.18	181.97	178.05	155.72
Special facilities 1/	7.28	--	--	--	--	--	--	--	--	--
Structural adjustment facility	40.90	40.90	40.90	40.90	40.90	40.90	40.90	40.90	40.90	40.90
Enhanced structural adjustment facility 2/	137.10	224.10	224.10	272.10	272.10	320.10	320.10	368.10	368.10	368.10
<u>(In percent of quota)</u>										
Total Fund credit outstanding (end of period) 2/	249.18	272.95	267.63	274.81	271.32	280.25	278.33	288.98	287.07	276.14
Tranche policies	158.58	143.37	138.05	121.75	118.26	103.72	101.80	88.98	87.07	76.14
Special facilities 1/	3.56	--	--	--	--	--	--	--	--	--
Structural adjustment facility	20.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00
Enhanced structural adjustment facility 2/	67.04	109.58	109.58	133.06	133.06	156.53	156.53	180.00	180.00	180.00
Memorandum item:										
Trust Fund loans outstanding (end of period)	4.62	2.98	1.82	0.75	0.33	0.33	--	--	--	--
In millions of SDRs	2.26	1.46	0.89	0.37	0.16	0.16	--	--	--	--
In percent of quota										

Source: IMF, Treasurer's Department.

1/ Compensatory financing facility.

2/ Including use of ESAP Trust resources.

Economic developments and prospects in Ghana are summarized in Tables 2-9, which are set out in the relevant sections of this report; they are also depicted in Charts 1-8 that are presented at the end of the report.

II. Background

Since the adoption of the Economic Recovery Program in April 1983, the Ghanaian authorities have successfully implemented a wide range of structural and financial reforms, supported by substantial and timely external assistance. These reforms have involved a reorientation of economic incentives in favor of directly productive activities and exports through a progressive liberalization of the exchange and trade system, including the introduction in September 1986 of a weekly auction for foreign exchange, substantial increases in real producer prices for cocoa and other cash crops, and the elimination of most price and distribution controls; a gradual rehabilitation of economic and social infrastructure in the context of a rationalized public investment program; and the initiation of measures designed to promote the private sector and improve public sector management. At the same time, the pursuit of appropriate fiscal and monetary policies has contributed appreciably to the reduction of domestic and external financial imbalances. As a result, after a long period of economic deterioration, Ghana's economic and financial performance improved markedly during the four-year period through 1987: real gross domestic product (GDP) grew on average by 6 percent a year, allowing an annual increase in real per capita income of more than 3 percent; the rate of inflation (as measured by the national consumer price index) decelerated, on an end-of-period basis, from 142 percent in 1983 to 34 percent in 1987; and the overall balance of payments position switched from a large deficit to a sizable surplus.

Despite this improvement in overall economic performance, however, Ghana continued to face a number of structural and financial problems. Thus, the authorities decided to pursue their reform efforts in the context of a rolling medium-term program. As indicated in the previous PFP, the basic macroeconomic objectives of the program for 1988-91 were the following: (a) to achieve an average annual rate of growth of real GDP of at least 5 percent; (b) to reduce the rate of inflation, on an end-of-period basis, from 34 percent in 1987 to 5 percent in 1991; and (c) to generate substantial overall balance of payments surpluses, averaging US\$117.5 million a year, consistent with a reduction in the foreign liabilities of the Bank of Ghana, the elimination of external payments arrears, and a significant increase in gross official reserves. In addition, an important dimension of the program, stemming from the experience in previous years, was to address in a systematic manner the needs of the poorest and most vulnerable groups in Ghana.

4. Monetary and credit policies

In late 1989 and early 1990 a new system of monetary control will be introduced in three major phases. In the initial phase, to be completed by the end of 1989, the Bank of Ghana will absorb any existing excess reserves of commercial banks through weekly sales of securities with appropriate maturities and market-determined yields; the program thus contains a structural benchmark on the sterilization of the excess reserves of banks through the sale of nonrediscountable Bank of Ghana instruments, with 6- to 24-month maturities, amounting to at least C 6.0 billion during the three-month period ending December 1989. The central bank will also set up an appropriate framework for the monitoring and management of liquidity, while refining its reserve requirements and refinancing facilities. In addition, by the end of 1989, the Government will recapitalize the Bank of Ghana by absorbing its large accumulated revaluation losses (amounting to some C 243 billion at end-June 1989), replacing them with special government securities offering a yield sufficient to permit the central bank to conduct monetary policy without being constrained by considerations regarding its own profitability. In the intermediate phase, and with a view to ensuring a smooth transition, the Bank of Ghana will begin monitoring developments on the basis of the new system, while maintaining credit ceilings on individual banks and absorbing any newly generated excess reserves. The gradual transition to the new system would give the Bank of Ghana time to train the necessary staff and gain experience in monitoring the movements in liquidity. In the third and final phase, during the second quarter of 1990, the credit ceilings on individual banks will be removed and replaced by primary reliance on market-based instruments of control and limits on the net domestic assets of the Bank of Ghana.

In view of the targeted growth of real GDP, as well as the targets for inflation and net foreign assets, the program allows for an overall monetary expansion of 22.9 percent in 1989 and 17.2 percent in 1990 (Table 5). This assumes a continued, albeit moderate, drop in velocity. Accordingly, the growth of net domestic assets of the banking system is to be limited to 15.1 percent in 1989 and 11.6 percent in 1990; relative to the stock of broad money at the beginning of the period, the expansion of net domestic assets will thus amount to 9.3 percent and 6.7 percent, respectively. However, in light of the envisaged sizable improvements in the Government's position vis-à-vis the banking system, credit to the rest of the economy (excluding cocoa financing) could increase by 28.4 percent in 1989 and 25.5 percent in 1990, in both cases significantly more than the projected growth of nominal GDP. Consistent with these targets, and the seasonality of credit requirements, the proposed performance criteria and quantitative benchmarks regarding the monetary program for the year ending June 1990 are set out in Appendix I.

5. Balance of payments and external debt

Although Ghana's external position continues to be adversely affected by the deterioration in world cocoa prices, strong growth in export volumes and substantial disbursements of grants and concessional loans are expected to generate sizable overall balance of payments surpluses in 1989 and 1990.

In 1989, for the third successive year, Ghana is likely to experience a deterioration in its terms of trade. The average price for Ghana's cocoa exports is projected to decline by as much as 31 percent, to US\$1,444 per ton (compared with a peak of US\$2,407 per ton in 1986). Thus, although export volume is expected to increase appreciably, cocoa export earnings are projected to decline by about 10 percent, to US\$418 million (Table 6). Similarly, despite a significant increase in gold export volume, the value of gold exports is projected to decline slightly, owing to a 15 percent drop in the export price. The continued strong growth of nontraditional exports, however, would limit the decline in total export receipts to about 4 percent. Imports are programmed to rise by 9 percent, mainly on account of an increase in project-related imports financed with external assistance. As a result, the trade deficit is projected to more than double. Despite a decline in interest payments falling due and a recovery in private transfers, the current account deficit, excluding official transfers, is expected to widen from US\$264 million (5.1 percent of GDP) in 1988 to US\$375 million (7.7 percent of GDP) in 1989.

With the continued strong support of Ghana's adjustment efforts by the donor community, however, net inflows of official transfers and disbursements of long-term concessional loans are expected to rise by 19 percent to US\$576 million in 1989; official transfers alone are projected to increase by 37 percent to reach US\$239 million. Inflows of official medium-term capital are expected to decline further as a result of new arrangements for the financing of oil imports, but inflows of private direct investment are likely to register a significant improvement associated with the granting of mining concessions to several foreign investors. On this basis, the balance of payments is programmed to register an overall surplus of US\$110 million in 1989, or US\$15 million less than in 1988. Together with the programmed net use of Fund resources, the overall surplus would enable the authorities to reduce external payments arrears by US\$45 million and other central bank liabilities by US\$55 million, while allowing for an increase in gross official reserves of US\$14 million. In this regard, appropriate performance criteria and quantitative benchmarks are proposed in Appendix I for the second half of 1989, as well as for the first half of 1990.

The improvement in the maturity profile of Ghana's external debt, involving an increase in the share of long-term debt in total debt, will contribute to a substantial reduction in the debt service ratio in the period ahead. However, in view of the still heavy debt burden, the

authorities will continue their prudent debt management policy by strictly limiting the contracting of nonconcessional government and government-guaranteed loans in 1989 to US\$85 million for maturities of 1-12 years, with a subceiling of US\$60 million for maturities of 1-5 years. The same limits are proposed on an indicative basis for 1990.

6. Performance criteria and benchmarks

The proposed second annual arrangement under the ESAF includes a number of quantitative performance criteria, a structural performance criterion, and several structural benchmarks, as set out in Appendix I. It should be noted, however, that the quantitative benchmarks for end-March and end-June 1990 are indicative; definitive benchmarks, including appropriate changes to reflect progress in the envisaged monetary policy reform, will be established at the time of the midterm review of the program with the Fund to be completed by end-May 1990. The disbursement of the second loan under the second annual ESAF arrangement will also be subject to the completion of the midterm review. In addition, the standard clauses regarding the exchange and payments system will constitute performance criteria.

VI. Staff Appraisal

Since the adoption of the Economic Recovery Program in April 1983, Ghana's economic and financial situation has improved markedly. The growth of real GDP has averaged 6 percent a year, permitting a steady increase in real per capita income; the rate of inflation has been reduced appreciably, although not sufficiently; and the external position has registered a major turnaround, with the overall balance of payments switching from a large deficit into a sizable surplus. These improvements have been made possible by the effective implementation of a number of far-reaching structural and financial reforms, supported by substantial and timely external assistance. Most notably, the extensive and sustained efforts of the Ghanaian authorities to liberalize the economy have led to a fundamental reorientation of incentives in favor of directly productive activities and exports, as well as saving and investment. The critical elements in this process have been the progressive liberalization of the exchange and trade system; the elimination of most price controls; the considerable increases in real producer prices; the much-needed rehabilitation of infrastructure; the initiation of reforms in the state enterprise sector; and the supportive stance of fiscal policy which, together with external assistance, has allowed a reduction in the Government's domestic indebtedness.

In 1988 and early 1989 a flexible exchange rate policy was pursued, together with the liberalization of the exchange and trade system. In particular, commercial banks and other dealers were allowed to establish bureaux to deal in foreign exchange at freely determined prices; access to the foreign exchange auction was widened to include the funding of virtually all imports and certain service payments and transfers; and the

import licensing system was abolished. Producer prices for cocoa and other cash crops were further increased, while additional steps were taken to improve the operations and financial position of the Cocoa Board. At the same time, fiscal policy continued to be directed toward mobilizing resources in support of the rehabilitation of infrastructure and other high priority outlays. Monetary policy reform was also continued with the liberalization of interest rates and the elimination of all controls on the sectoral allocation of credit, apart from a minimum requirement for agriculture. Furthermore, a number of institutional reforms were initiated or pursued, and the authorities began implementing a special program of actions to mitigate the social costs of adjustment.

With the effective implementation of these policies, the basic macroeconomic objectives of the program supported by the first annual arrangement under the ESAF were largely realized. In 1988 real GDP grew by an estimated 6.2 percent, significantly more than the target of 5.5 percent, implying an increase in real per capita income of the order of 3.5 percent. At the same time, the rate of inflation decelerated from 34 percent in 1987 to 27 percent in 1988, but fell short of the target of 20 percent. Despite a second consecutive year of deterioration in the terms of trade, Ghana's external position also continued to improve, with the overall balance of payments surplus being on target at US\$125 million in 1988. Economic activity remained brisk in the first half of 1989, while the rate of inflation slowed further. All the quantitative performance criteria and benchmarks of the program were met, but the abolition of the import licensing system, a structural performance criterion, was slightly delayed and there were some minor deviations with respect to a few structural benchmarks. Overall, therefore, considerable progress was made under the program, with adjustment being accompanied by strong economic growth.

The recent substantial improvement in Ghana's situation notwithstanding, concerted efforts are still required to address a number of structural, institutional, and financial problems that constrain the achievement of self-sustaining growth in the economy; such efforts are also needed to bring inflation under control, as well as to strengthen the underlying external position. Against this background, the authorities have updated and extended their program of structural and financial adjustment to cover the period 1989-92. In so doing, they have rightly focused their attention on consolidating the economic and financial gains achieved thus far, while seeking to accelerate fundamental reforms in a difficult external environment; given the magnitude of the decline in world cocoa prices, the program has been designed to smooth the adjustment path by rephrasing the desired reduction in the inflation rate and scaling down the originally targeted buildup of gross official reserves. Accordingly, the basic macroeconomic objectives of the program for 1989-92 are to achieve an average annual growth of real GDP of at least 5 percent; progressively reduce the rate of inflation to 5 percent in 1992; and generate overall balance of payments surpluses averaging about US\$85 million a year.