FOR AGENDA

SM/07/155
Correction 1

May 16, 2007

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Ghana—Ex Post Assessment of Longer-Term Program Engagement**

The attached corrections to SM/07/155 (5/7/07) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff Analysis or Views

Page 4, para. 3, last line, footnote 1: replaced to read "The report was prepared by an interdepartmental staff team, comprising Mr. Hviding (team leader, PDR), Mr. Akitoby (FAD), Ms. Brixiova (PDR), Mr. Iossifov (AFR), and Ms. Loukoianova (AFR). A video conference was held with Dr. Osei, Deputy Minister of Finance, in mid-January 2007."

Page 27, Table 3, row 4, column 5: for "na" read "SDR 26.35 million"
rows 7 and 8, column 2: "na" inserted

Questions may be referred to Mr. Hviding, PDR (ext. 34544).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

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Department Heads

EXECUTIVE SUMMARY

During June 1995 to October 2006, Ghana had three back-to-back arrangements with the Fund: the first, covering 1995–1998, was granted under the Enhanced Structural Adjustment Facility (ESAF); the second ESAF, covering 1999–2002, was converted to the Poverty Reduction and Growth Facility (PRGF); the last PRGF covered 2003–2006. Throughout the period under review, Ghana's growth performance has been better than most relevant comparators, and poverty has been reduced.

The period under review can be divided into two distinct periods: not so successful stabilization (1995–2002), and quite successful stabilization (2003–2006):

- The first two Fund-supported programs, 1995 through 2002, were plagued by delays in mid-year reviews and eventually went off track. A number of quantitative and structural performance criteria were missed. Despite some progress in structural reform, lack of fiscal discipline led to increased indebtedness and inflationary budget financing.

- Despite recent fiscal slippage, the last program was relatively successful in improving fiscal discipline and bringing inflation under control (eventually reaching single digits in early 2007).

The assessment identifies the following three lessons for the Fund's future engagement with Ghana and other similar countries:

- Assessment of the sustainability of debt needs to be based on realistic assumptions about real growth, exports, and the real effective exchange rate. Although in recent years growth has exceeded expectations, growth projections for the early Fund programs were overly optimistic; the potential overvaluation of the exchange rate was not discussed.

- Institutions matter. Ghana's success in its reform program is largely embedded in the strengthening of institutions that allowed for greater public ownership of the reforms. The inflation reduction strategy was ultimately successful due to a strengthening of monetary institutions and because a system of checks and balances and overview mechanisms helped constrain public sector expenditures. Future Fund engagement should seek ways to support initiatives to bolster such institutions.

- Continual structural reform is essential to ensure that macroeconomic stabilization is durable. Recent fiscal slippages underscore the need to further strengthen fiscal institutions to improve expenditure control, in particular during pre-election periods. While, in other areas, many reforms are outside the Fund's area of expertise, the Fund needs to engage closely with the World Bank and other development partners to ensure that progress is made in key sectors.

In reviewing future options for engagement, **continuation of a formal relationship, whether in the form of a Policy Support Instrument (PSI) or a low-access PRGF, could help mitigate the risk of further pre-election policy slippage.** Such a program relationship would, however, need to be based on sound policies to which the authorities adhere fully.

I. INTRODUCTION

1. **Ghana is widely considered an African success story.** Thus, in a continent that has repeatedly come short of expectations, it gives hope for a better future, not only for Ghana itself but for many other countries in the region. The achievements most commonly cited are its sustained growth rate which has led to a 50 percent increase in per capita GDP over some 20 years and a marked reduction in poverty, the maturity of its democratic institutions, and the lack of major armed conflict in an otherwise difficult neighborhood.

2. **The purpose of this Ex-Post Assessment is to take a closer look at the Ghanaian experience, with particular attention to the Fund's role.** The assessment tries to identify lessons for Ghana itself and for the Fund's future engagement in Ghana and similar countries. In light of these lessons, it also discusses options for future Fund engagement in Ghana and how and when Ghana might exit from its long-term program engagement with the Fund.

3. **The assessment covers a period of about 11 years, from the approval of the 1995-1999 ESAF to the expiration of the 2003-2006 PRGF.** Besides reviewing staff reports and internal memos, the assessment team has also drawn on external research, World Bank reports, interviews with mission chiefs, and the authorities. The team leader visited Accra twice, first in December 2006 for initial discussions, then in February 2007 to present the findings.[1]

4. **The paper is organized in three main parts.** The first part reviews Ghana's economic performance, concentrating on: why inflation was persistently higher than expected; why debt became unsustainable; and whether the successes are solidly anchored or risk being reversed. The second part reviews the role of the Fund in Ghana's achievements and summarizes the main lessons. The paper concludes with an assessment of future options for Ghana and vis-à-vis the Fund.

II. GHANA'S EXPERIENCE

A. Overview

5. **The introduction of the Economic Recovery Program in 1983 led to a dramatic change in Ghana's economic performance.** While up to then the economy was marred by spouts of hyperinflation and declining output, Ghana's output has since exceeded that of most other sub-Saharan African countries (Figure 1). Since 1983, annual growth has averaged 4.6 percent, compared to 3.6 percent for sub-Saharan Africa. In per capita real PPP terms, the performance is even better—1.8 percent, compared to 1.0 percent in sub-Saharan Africa.

[1]The report was prepared by an interdepartmental staff team, comprising Mr. Hviding (team leader, PDR), Mr. Akitoby (FAD), Ms. Brixiova (PDR), Mr. Iossifov (AFR), and Ms. Loukoianova (AFR). A video conference was held with Dr. Osei, Deputy Minister of Finance, in mid-January 2007.

Table 3. Ghana: Cases of Misreporting and Non-complying Disbursements [1]

Year(s) of misreporting:	1999 - 2000	2000 - 2001	2000-2001	2003
Relevant arrangement(s):	First annual arrangement under the 1999 PRGF	Second annual arrangement under the 1999-2002 PRGF	Second annual arrangement under the 1999-2002 PRGF	2003-2006 PRGF
Number of non-complying purchase(s)	1	2	2	1
Amount of non-complying purchase(s):	SDR 22.14 million	SDR 26.75 million	SDR 89.33 million	SDR 26.35 million
Dates of non-complying purchase(s)	Nov-1999	Sep-2000	Sep-2000, July-2001	Dec-2003
Type of measure(s) affected:	Continuous PC prohibiting the introduction or modification of a multiple currency practice (MPC).	Prior action to eliminate any outstanding eliminate external payment arrears; PC limiting the contracting or guaranteeing new nonconcessional external debt	PC on reserve money (ceiling)	Automatic adjustment of water tariffs.
Measure(s) originally:	na	0	cedis 1,570 million cedis 2,261 million	na
Measure(s) after revision:	na	US$38 million and US$145 million, respectively	cedis 2,338 million cedis 2,932 million	na
Nature of misreporting:	In November 1999, authorities introduced special swap transactions without informing the Fund staff, which gave rise to an inadvertent multiple currency practice (MCP).	The Fund staff was not informed about the nonpayment of US$ 38 million of external obligations, even though these arrears were recorded in the August 2001 Bank of Ghana report. The misreporting of nonconcessional debt arose from the use of an illegitimate method of calculating concessionality; six nonconcessional loans contracted between June 30 and December 31, 2001.	Inappropriate adjustments had been made to data on currency in circulation. The new Governor reported the misreporting promptly after he took office.	The minister in charge of the water sector put the scheduled tariff increase on hold. The Ministry of Finance and Economic Planning was not aware of this action and assumed that the increase had been implemented.
Remedies:	The authorities discontinued entering into new special swaps, and took steps to make the foreign exchange market free and flexible. The authorities implemented several additional measures to achieve objectives of the PRGF arrangement.	The authorities repaid about US$32 million by April 2001, but contracted new arrears in the meantime. As for the PC on nonconcessional debt, the method of the of the grant element was clarified, and the authority to contract external debt was centralized in the Aid and Debt Management Unit.	Fund staff worked with Bank of Ghana officials to recompile reserve money data directly from the Bank of Ghana's audited financial statements. Bank of Ghana's internal control procedures were improved.	Water tariffs were adjusted and assurances were made about future adjustments.
Board decision:	Waiver of nonobservance of PC, because (i) the deviation was temporary; (ii) Ghana adopted additional policy measures to achieve the objectives of the program.	The deviation was neither minor nor temporary, as the arrears were large, had a significant impact on program performance, and the authorities continued to have these arrears at the time of the August 2000 Board meeting. Ghana was asked to repay SDR 26.75 million together with any interest accrued.	The September 2000 disbursement had already been repaid (e.g., see the misreporting of external payment arrears); the nonobservance of July 2001 PC was waived, because Ghana had adopted additional measures appropriate to achieve the objectives of the program.	The nonobservance of the prior action was waived, due to the prompt reporting of the misreporting and the commitment to future adjustments.

Source: IMF staff

[1] PC stands for performance criterion.

43. **In 2001-2003, the sharp increase in donor support and unpredictability of disbursements complicated macroeconomic policy implementation** (Appendix III and Figure 6). Aid inflows were used both to build up reserves and to strengthen the fiscal position: Ghana has been referred to as an example of the "don't spend, don't absorb" approach.[14] The monetary impact of the inflows was significant since the government used the improved fiscal position to repay domestic debt instead of reducing its net debt to the central bank obligating the central bank to engage in increasingly large sterilization operations.

44. **Uncertain aid inflows contributed to the macroeconomic instability during 2000-2002**. In particular, the nonobservance of donor conditionality on divestiture led to a large drop in program aid in 2000, contributing to external financing problems and the collapse of the cedi. Thus, in these years, better donor coordination could potentially have softened the macroeconomic impact of the policy slippages. Better prediction of the impact of policy slippages on aid disbursement could also have helped (see Appendix III).

B. Could the Fund have Done More to Ensure Progress in Structural Reform?

45. **Despite relatively successful macroeconomic stabilization, risks remain due to repeated delays in structural reform, particularly in the energy and public sectors.** Although conditionality required the introduction of a market based energy-pricing mechanism and increased private participation in the sector, progress was slow. Public sector reform was not a focus of Fund conditionality until towards the end of the 2003-06 program, when the macro-relevance of progress in this area became increasingly clear: ceilings on the aggregate wage bill of the public sector were introduced in the last three reviews together with structural performance criteria on the need to establish a computerized personnel database and a report on public sector salary structure.

46. **On energy sector reform, a review of the structural performance criteria on the energy sector shows a strikingly low degree of compliance.** Performance criteria on the introduction of an automatic pricing mechanism were in several instances undone soon after being introduced. The performance criterion on the introduction of the automatic price adjustment mechanism on petroleum was applied four times: first met in the 2003 program, it had to be reintroduced in the 2004 and 2005 programs after the mechanism was not allowed to work. Similarly, the automatic pricing mechanism on electricity was introduced three times and—while the performance criterion was met twice—such a mechanism has still not been fully implemented. Thus, while about half of the performance criteria on the energy sector (including divestitures of energy companies) were not met or waived, most of the performance criteria were only temporarily met as the same or similar performance criteria had to be reintroduced at a later stage. Similarly, a performance criterion on the divestiture of the state's ownership of energy companies was waived at several reprises.

[14] "Macroeconomic Management of Aid Inflows—Experience of Low-Income Countries and Policy Implications," SM/05/306.