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**FOR
AGENDA**

EBS/86/224

CONFIDENTIAL

September 26, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Ghana - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on a request from Ghana for a stand-by arrangement equivalent to SDR 81.8 million, which will be brought to the agenda for discussion on a date to be announced. Draft decisions appear on page 43.

Mr. Kratz (ext. 6968) or Mr. Lorie (ext. 8385) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

GHANA

Use of Fund Resources - Request for Stand-By Arrangement

Prepared by the African Department and the
Exchange and Trade Relations Department

(In consultation with the Fiscal Affairs, Legal,
and Treasurer's Departments)

Approved by A.D. Ouattara and Eduard Brau

September 26, 1986

I. Introduction

In the attached letter, dated September 23, 1986, the Government of Ghana requests from the Fund a stand-by arrangement in support of a 12-month adjustment program covering the period from October 1986 to September 1987. The arrangement would be for an amount equivalent to SDR 81.80 million, representing 40 percent of quota. The entire amount would be provided from borrowed resources. Ghana has made all scheduled purchases under the 16-month stand-by arrangement, for an amount of SDR 180 million, which expired on December 31, 1985. The proposed new program is seen as a bridge to a medium-term program that could be supported from early 1987 by the use of Fund resources under the Extended Fund Facility and the Structural Adjustment Facility.

Discussions on a medium-term program were initiated in the context of Fund missions that visited Accra in December 1985 and March 1986. During the March visit, it became apparent that developments in the areas of credit policy and wage policies during the last few months of 1985 and in the early part of 1986 could undermine the stabilization gains obtained since 1983. The Ghanaian authorities recognized that the structural and institutional reforms envisaged to promote growth and balance of payments viability in the medium-term first necessitated the urgent consolidation of these stabilization gains, and that in view of the time constraint, this objective would have to be achieved in the context of a stand-by program. However, they continue to believe that the above-mentioned reforms would best be implemented in the context of a medium-term program, which remains their objective. The discussions on the proposed stand-by arrangement were held in Accra between June 15 and July 2, 1986. The Ghanaian representatives included Dr. Botchwey, PNDC Secretary for Finance and Economic Planning, Governor Addo of the Bank of Ghana, Dr. Abbey, currently Ghana's High Commissioner to Canada, and Messrs. Obeng, PNDC Coordinating Secretary and Ahwoi, PNDC Revenue Secretary, among others. The staff representatives were Messrs. Kratz (head-AFR), Lorie (AFR), Hemming (FAD), Thomsen (ETR), Young (EP-AFR),

and Ms. Canizares (secretary-AFR). ^{1/} They were assisted by Mr. Sharer, the Fund resident representative in Accra. Mr. Salehkhoulou, Executive Director representing Ghana, participated in some of the policy discussions. Modifications to the targets and a strengthening of measures agreed in early July, made necessary by evidence that the balance of payments and budgetary situation had significantly worsened, were negotiated with the Ghanaian authorities in Accra and Washington during August and early September 1986.

The proposed stand-by arrangement would provide for five equal purchases of SDR 16.36 million, or 8 percent of quota, each (Table 1). The first purchase would be made upon approval of the program by the Fund; the second after November 14, 1986, upon meeting end-September performance criteria; and the third after February 14, 1987, upon meeting end-December performance criteria and completion of a review with the Fund. The fourth and fifth purchases under the arrangement could be made after May 14, 1987 and August 14, 1987 upon meeting end-March and end-June performance criteria, respectively, which will be established during the review mission, expected to take place in October/November 1986. Assuming that all the purchases under the proposed arrangement are made, the Fund's holdings subject to repurchase would amount, at the expiration of the arrangement, to 280.36 percent of quota, compared with 292.03 percent at the beginning of the arrangement. The discussions of a program under the Extended Fund and Structural Adjustment Facilities could be initiated during the October/November 1986 mission, which will also conduct the 1986 Article IV Consultation with Ghana.

The role of the World Bank in assisting Ghana's economic recovery program has grown considerably in the past three years, with the implementation of three major new program loans in addition to new project loans. These programs included Reconstruction Import Credits (RICs I and II) totalling US\$127 million, an Export Rehabilitation Project (ERP) of US\$93 million, and an Industrial Sector Adjustment Credit (ISAC) of US\$57 million. The disbursements under the RICs and the ERP have amounted to about US\$60 million and US\$25 million, respectively; the disbursements under the ISAC began this summer. For 1985 alone, total Bank disbursements were US\$72 million; they are projected to increase significantly in 1986 to reach some US\$128 million. The Bank has also been instrumental in mobilizing the support of bilateral and multilateral donors in the context of annual meetings of the Consultative Group for Ghana since 1983, which it has chaired. Total commitments generated by the last meeting of November 1985 are estimated at US\$500 million; it is expected that the next meeting will take place in early 1987. The collaboration between the Bank and Fund staffs involved with Ghana has been very good, both at the technical and

^{1/} The initiating missions of December 1985 and March 1986 also included Messrs. Chand (FAD) and Huh (ETR). Mr. Gondwe (AFR) participated in the March 1986 mission.

Table 1. Ghana: Purchases and Fund Position During Period of Proposed Stand-By Arrangement

	Outstanding at beginning of arrange- ment (Oct. 1, 1986)	October 1986	Nov.-Dec.	Jan.-Apr.	May-August 1987	September
(In millions of SDRs)						
Transactions under tranche policies (net) <u>1/</u>	--	16.36	12.72	2.06	-11.13	13.65
Purchases	--	16.36	16.36	16.36	16.36	16.36
Ordinary resources		--	--	--	--	--
Borrowed resources		16.36	16.36	16.36	16.36	16.36
Repurchases	--	--	3.64	14.30	27.49	2.71
Ordinary resources		--	3.64	11.98	18.77	2.71
Borrowed resources		--	--	2.32	8.72	--
Transactions under special facilities (net) <u>2/</u>	--	--	-15.06	-15.06	-30.12	--
Purchases	--	--	--	--	--	--
Repurchases	--	--	15.06	15.06	30.12	--
Total Fund credit outstanding (end-of-period)	597.20	613.56	611.22	598.22	556.97	570.62
Tranche policies <u>1/</u>	418.50	434.86	447.58	449.64	438.51	452.16
Special Facilities <u>2/</u>	178.70	178.70	163.64	148.58	118.46	118.46
(As percent of quota)						
Total Fund credit outstanding (end-of-period)	292.03	300.03	298.89	292.53	272.36	279.03
Tranche policies <u>1/</u>	204.65	212.65	218.87	219.87	214.43	221.10
Special facilities <u>2/</u>	87.38	87.38	80.02	72.66	57.93	57.93

Sources: IMF, Treasurer's Department; and the proposed stand-by.

1/ Ordinary and borrowed resources.

2/ Compensatory financing facility.

policy levels, including mutual participation in each other's missions. Close contacts are expected to be maintained, and will be essential to ensure consistent policy recommendations, in the context of preparations for a World Bank Structural Adjustment Credit (SAC), and further Fund programs under the Extended and Structural Adjustment Facilities.

II. Background

Ghana's critical economic situation at the end of 1982 was the result of almost ten years of economic mismanagement, made worse by unfavorable external developments, in particular, deteriorating terms of trade. Large fiscal deficits were mostly financed through domestic credit expansion. Rapid money growth fueled inflation which, in the absence of exchange rate adjustment, led to a severe real appreciation of the cedi. The resulting sharp dislocation of relative prices drove resources away from the traded goods sector. It induced a prolonged decline in economic activity and real incomes, and a severe imbalance in Ghana's external position. The latter was compounded by the drying-up of external sources of financing, which exacerbated the foreign exchange constraint and hence the scarcity of imports. The lack of imported raw materials and spare parts led to a low level of capacity utilization throughout the Ghanaian economy, and contributed both to domestic inflation and the rundown of the productive capacity. In addition, the erosion of traditional tax bases (especially foreign trade bases) resulted in a substantial fall in both the revenue and expenditure (including investment) ratios to, respectively, about 5 and 8 percent of GDP by the early 1980s. It was accompanied by the progressive deterioration of the economic and administrative infrastructure of the country. Private saving and investment also fell, reflecting the contraction of incomes, the unattractiveness of cedi denominated assets, and the lack of profitable investment opportunities owing to inappropriate relative prices.

The comprehensive Economic Recovery Program implemented by the Ghanaian authorities during the 1983-85 period was supported by two successive stand-by arrangements from the Fund, the first for an amount of SDR 238.5 million and covering the period August 1983 to July 1984, and the second for an amount of SDR 180 million and covering the period August 1983 to December 1985. A major objective of the program was to dramatically redirect incentives and resources to sectors in which Ghana has strong natural advantages (such as cocoa, gold, timber, and a number of agro-industries), and away from inefficient industrial and trading activities. Significant progress in this direction was accomplished through a series of devaluations of the cedi from $\text{C} 2.75 = \text{US}\1 in early 1983 to $\text{C} 60 = \text{US}\$1$ in late 1985. The latter implied a cumulative real depreciation of some 87 percent over the period (Table 2) and brought the ratio between the parallel and official exchange rate from about 15 to 2.5. These adjustments were supported by a dismantling of a previously extensive system of price controls, which allowed a broad pass-through of generally higher import costs onto wholesale and retail

Table 2. Ghana: Economic and Financial Indicators, 1983-86

	1983 Actual	1984 Actual	1985 Program 1/	Prov.	1986 Program
(Annual percentage change)					
National income and prices					
GDP at constant prices	-4.8	10.7	5.3	5.8	5.5
GDP deflator	123.7	33.6	25.6	15.5	25.0
Consumer price index	121.9	40.2	20.0	10.4	25.0
Real producer price for cocoa (index: 1972=100)	32.7	35.9	53.9	58.6	74.1
Minimum wage in real terms (index: 1972=100)	14.5	16.4	29.1	31.6	32.5
Real public sector wages (index: 1972=100)	16.4	18.4	26.7	29.0	46.1
Fixed investment to GDP (ratio)	3.7	6.0	...	10.0	12.0
Domestic saving to GDP (ratio)	3.0	5.2	...	5.0	8.0
Money and credit 2/					
Net domestic assets	41.2	32.1	42.2	68.5	27.9
Of which: net claims on Government	(23.5)	(8.4)	(8.8)	(8.8)	(11.0)
Broad money (M2)	38.1	39.3	31.7	57.6	19.0
Velocity (ratio)	9.0	9.5	8.9	7.4 3/	6.6
Interest rate 4/	12.5	16.0	18.0	18.0	20.0
External sector					
Exports, f.o.b 5/	-27.6	28.7	15.6	11.8	14.4
Of which: cocoa	(-32.2)	(38.4)	(10.6)	(8.0)	(21.6)
Imports, f.o.b 5/	-3.1	9.9	33.3	6.7	17.6
Of which: oil	(-47.5)	(--)	(41.0)	(23.6)	(-38.8)
Export volume	-26.7	-3.9	28.2	21.9	7.0
Import volume	-0.1	13.3	32.9	6.4	27.7
Terms of trade	1.9	38.0	-10.1	-8.6	33.4
Nominal effective exchange rate	-89.9	-31.6	...	-27.5	...
Real effective exchange rate	-76.6	-30.8	-20.0	-17.5	...
(In percent of GDP) 6/					
Central government finances					
Revenue (excluding grants)	5.5	8.0	11.5	11.6	17.8
Total expenditure and net lending	8.2	10.1	14.6	14.4	19.5
Overall deficit (excluding grants)	-2.7	-2.1	-3.1	-2.8	-1.7
Overall deficit (including grants)	-2.7	-1.8	-2.6	-2.3	-0.2
External current account deficit (-)	-2.9	-1.3	-5.9	-3.0	-5.1
External debt outstanding	26.7	37.6	43.0	39.7	69.6
(In percent of exports of goods and services)					
Debt service ratio 7/					
Including the Fund	30.9	29.4	47.6	51.6	52.5
Excluding the Fund	26.8	25.9	40.8	43.8	42.5
(In millions of U.S. dollars)					
Overall balance of payments	-243.0	-121.0	-60.0	-98.1	-81.0
External payments arrears 8/	439.5	231.7	176.6	175.0	198.2
Gross international reserves 8/	184.6	199.4	...	126.2	137.0
Equivalent weeks of imports	16.2	16.5	...	9.8	9.1

Sources: Data provided by the Ghanaian authorities; and Fund staff projections.

1/ EBS/85/110.

2/ Based on end of period; broad monetary coverage for 1986.

3/ On broad monetary coverage basis, 1985 velocity was 5.9.

4/ On 12-month deposits.

5/ In US dollar terms.

6/ Uses latest GDP revisions.

7/ Government and Government guaranteed external debt.

8/ End of period; from 1984, gross reserves are on a disposable basis.

prices. After a short transition period, gasoline prices also fully reflected the adjustments of the exchange rate. In addition, the successive devaluations made it possible to finance substantial increases of the cocoa producer price which rose from ¢ 12,000 per ton to ¢ 56,600 per ton between 1983 and 1985, restoring its real value from about 30 to almost 60 percent of the 1972 level.

Another objective of the Fund supported adjustment effort has been to restore fiscal and monetary discipline to provide a climate for growth in the context of a sustainable external balance of payments situation. The deceleration in the expansion of overall net domestic assets during 1983-85 was limited by the need to provide the non-government sectors with domestic credit to absorb increased external resources at a time of rapid depreciation of the exchange rate. The financing of the government deficit by the domestic banking system was, however, sharply curtailed, and amounted to less than 0.6 percent of GDP in 1985, compared to 1.4 percent in 1983. As a result, the expansion of net claims on government fell to below 9 percent in both 1984 and 1985, compared with 24 percent in 1983 (narrow coverage of the banking system). 1/ The size of the government deficit itself, excluding foreign-financed project expenditure, was reduced to an average of less than 2.4 percent of GDP in the period, compared to 4.6 percent in 1982, with year to year variations mostly reflecting variations in the availability of foreign financing. Both to support the stabilization effort, and to promote the mobilization and efficient allocation of domestic financial resources, the authorities pursued a more flexible interest rate policy which, through successive interest rate adjustments and a rapid decline in inflation, brought about positive real interest rates in 1985.

From the beginning of the recovery program, it was clear that to rebuild the economic and administrative infrastructure and to restore the most efficient part of the country's productive capacity, a major domestic resource mobilization effort, together with increased external assistance on concessional terms, would be required. With regard to domestic revenue, considerable progress was accomplished in the 1983-85 period, as total central government revenue in percent of GDP rose from 6 percent in 1982 to 11.6 percent by 1985. Most of this improvement was made possible by the impact of the exchange rate adjustment and larger trade volumes on the revenue from international transactions. But the improved budget position also reflected a strengthening of tax collection and a number of discretionary revenue measures, particularly in the nontax areas. As a result, it was possible to partially restore real wage and salary levels for civil servants after the severe erosion of the late 1970s and early 1980s, to increase modestly expenditure on maintenance and material, and investment outlays.

1/ Including the three primary commercial banks, but not the secondary banks.

While the authorities' commitment to adjustment policies, and adherence to the targets set under the two stand-by arrangements for the progressive reduction of external payments arrears, earned Ghana growing external assistance, actual disbursements of foreign aid fell consistently short of program targets throughout the 1983-85 period. As far as the budget was concerned, the authorities reacted to the short-fall in external assistance by reducing primarily capital expenditure in order to keep the financial program on track. The lower-than-projected level of available foreign financing also constrained the external current account deficit to between 2 and 3 percent of GDP, and as a result, limited the growth of imports of essential inputs, spare parts, and equipment. In volume terms, imports grew on average by 7 percent annually during the 1983-85 period, which represented only modest increases in view of the substantial rehabilitation needs of the economy.

Following the disastrous drought of 1983, which led to an 8 percent decline of real output of the agricultural sector and mainly accounted for the real GDP growth of minus 4.8 percent in that year, the level of economic activity picked up significantly in both 1984 and 1985. The real GDP growth of 10.7 percent in 1984 resulted mostly from the recovery of agriculture, as weather conditions improved and price incentives stimulated supply. The real GDP growth of 5.8 percent in 1985 was, on the other hand, mostly due to a 20 percent increase of industrial output, reflecting the greater availability of inputs in addition to the supply response from the removal of price controls. Price incentives and the more favorable weather also contributed to a recovery of cocoa production in the later part of the 1983-85 period, and exports of cocoa beans and products rose from a low of 165,000 tons in 1984 to 192,000 tons in 1985. The recovery of other traditional exports, in particular gold, proceeded at a slower pace, due to longer gestation periods for the rehabilitation of plant and equipment and for the improvement of managerial resources. Yet, owing to some progress in the rehabilitation of the transport infrastructure, and reflecting the greater incentives to exports provided by the successive exchange rate adjustments, timber exports more than doubled in volume between 1982 and 1985. The greater availability of supplies, particularly foodcrops, and the cautious demand management policies pursued by the authorities contributed to the sharp decline in inflation of the CPI from 122 percent in 1983 to just above 10 percent in 1985.

III. Implementation of the 1985 Program

1. Production and prices

The real GDP growth of 5.8 percent in 1985 turned out to be slightly higher than projected at the beginning of the program, because agricultural output increased by more than could be expected after the 1984 bumper crops, and because of a stronger than projected pick-up in industrial activity. In addition, inflation of the GDP deflator and CPI

of only 15.5 and 10.4 percent, respectively, was well below the program targets of 25 and 20 percent. The main reason for the better overall inflation performance lies in the absolute decline in food prices, by 11 percent, while the nonfood prices rose by 31 percent. The lower rise in the CPI in comparison with the GDP deflator resulted from a combination of factors. These included the greater weight attached to foodcrops in the CPI, the direct impact of official exchange rate adjustments on the domestic price of exportables in the GDP, and, especially, the fact that the inflation of the GDP deflator for manufactures (by more than 50 percent) was only partially reflected in retail prices, as scarcity rents were eroded.

2. Exchange rate policy

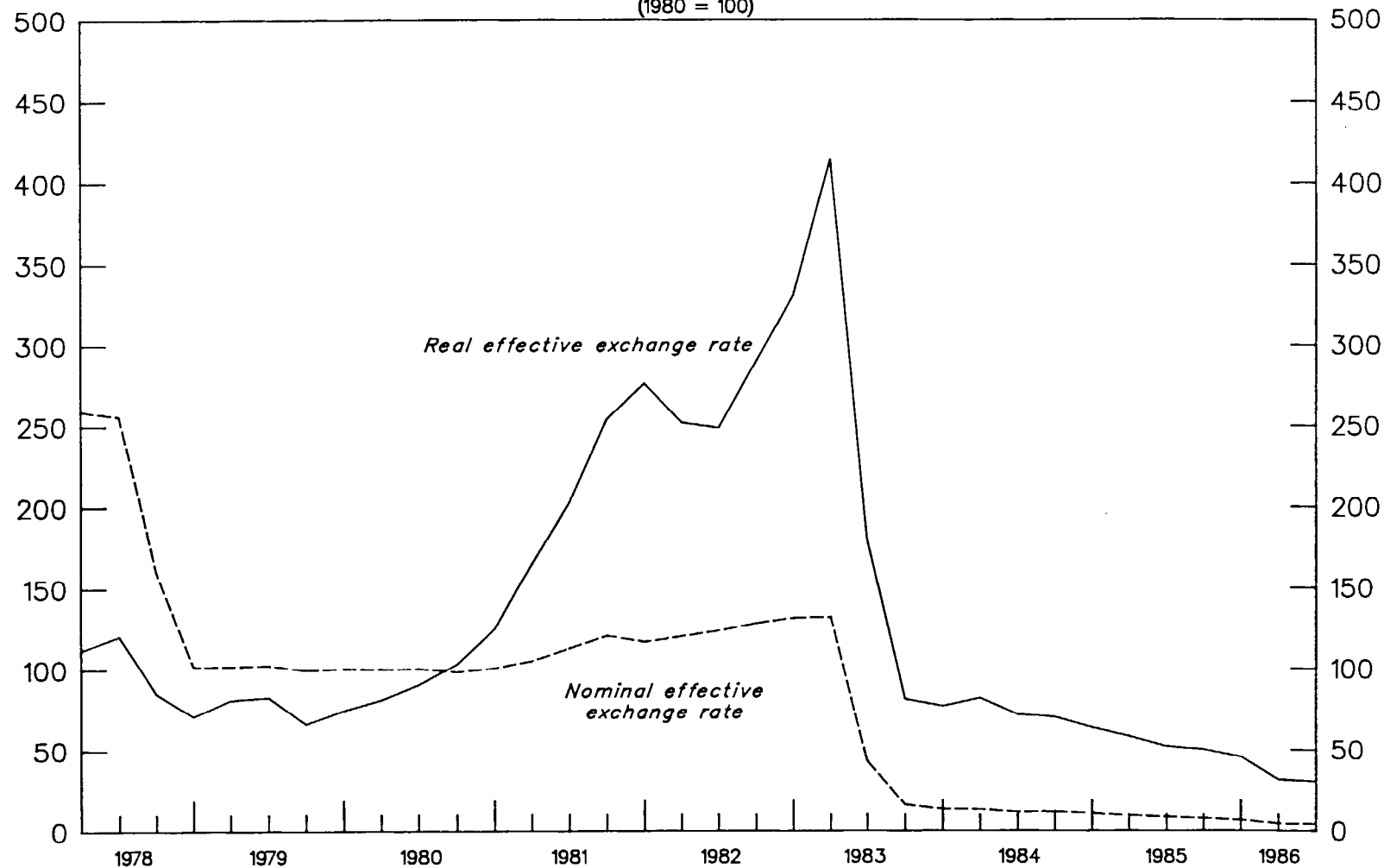
Under the 1985 program, the authorities undertook to adjust the unitary exchange rate periodically to effect a real trade-weighted depreciation of 20 percent during 1985. In accordance with this objective, the authorities adjusted the exchange rate from C 50 = US\$1 to C 53 = US\$1 on April 19, 1985, to C 57 = US\$1 on August 12, 1985, and to C 60 = US\$1 on October 7, 1985. By end-December 1985, and thus before the adjustment to C90=US\$1 on January 10, 1986, the trade-weighted real exchange rate index for Ghana had depreciated by 17.5 percent from its end-1984 basis and by 86.6 percent cumulatively since the beginning of the recovery program (Chart 1). (The parallel market exchange rate is reported to be currently in the range of C 170-200 = US\$1.)

3. Fiscal policies

The 1985 program envisaged a modest increase in the overall deficit ^{1/} of the central government operations from its 1984 level of 1.8 percent of GDP to some 2.6 percent, or C 8.6 billion, as a result of the greater availability and capacity to absorb projected higher levels of concessional foreign financing (Table 3). At the same time, domestic bank financing (narrow coverage) was programmed to be limited to C 2 billion, thus declining further in proportion of GDP. Within the limits set by this cautious fiscal policy stance, the 1985 program envisaged, however, to begin addressing the rehabilitation needs of a badly run-down economic and administrative infrastructure, particularly in the transport and communication areas, as well as the need to raise civil service wages and salaries, which remained less than 20 percent of their 1972 level in real terms. An increase in emoluments was viewed as a pre-condition to any improvement in public administration. Accordingly, total expenditure (including net lending) was programmed to increase by 76 percent in nominal terms from 1984. The program provided, in particular, for an 89 percent increase in wages and salaries (while maintaining a freeze on new hiring in the civil

^{1/} Not including foreign assistance tied to projects or its counterpart expenditures, estimated at about 2 percent of GDP in 1985.

CHART 1
GHANA
REAL AND NOMINAL EFFECTIVE EXCHANGE RATES, Q1 1978 TO Q2 1986
(1980 = 100)



Source: IMF, Information Notice System, trade weighted.

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Table 3. Ghana: Summary of Central Government Operations and Financing, 1983-1986

(In millions of cedis)

	1983 Actual	1984 Actual	1985 Prog. 1/	Actual	1986 Prog. 2/
Total revenue and grants	10,241	22,641	39,899	40,312	84,924
Tax revenue	8,459	17,929	32,976	32,130	70,139
Taxes on income and property	(1,780)	(4,125)	(6,016)	(7,993)	(14,382)
Taxes on domestic goods and services	(1,689)	(5,562)	(10,190)	(8,373)	(19,316)
Taxes on international transactions	(4,990)	(8,242)	(16,770)	(15,764)	(36,440)
Nontax revenue and grants	1,782	4,821	6,923	8,182	14,785
Grants	(57)	(914)	(1,790)	(1,620)	(6,685)
Total expenditure and net lending	15,175	27,485	48,510	47,892	85,797
Current expenditure	13,401	22,700	36,535	38,462	64,044
Wages and salaries	(3,800)	(5,055)	(12,059) 3/	(14,524) 4/	(26,272)
Other current expenditure	(9,601)	(17,645)	(24,476)	(23,938)	(37,772)
Capital expenditure and net lending 5/	1,774	4,785	11,975	9,430	20,754
Net lending	(420)	(791)	(3,950)	(2,127)	(6,401)
Special efficiency	--	--	--	--	1,000 6/
Overall deficit 5/	-4,934	-4,844	-8,610	-7,580	-873
Financing 5/	4,934	4,844	8,610	7,580	873
Foreign (net)	970	1,816	5,360	3,522	-3,627
Borrowing	(...)	(5,073)	(11,556)	(9,562)	(13,776)
Repayments	(...)	(-3,257)	(-6,196)	(-6,040)	(-17,403)
Domestic (net)	3,964	3,028	3,250	4,058	4,500
Banking system 7/	(2,145)	(2,437)	(2,750)	(3,373)	(3,000)
Primary banks		(1,760)	(2,000)	(2,000)	(3,000)
Secondary banks		(677)	(750)	(1,373)	
(In percent of GDP) 7/					
Total revenue and grants	5.5	8.3	12.0	12.1	19.3
Revenue (excluding grants)	5.5	8.0	11.5	11.6	17.8
Total expenditure and net lending	8.2	10.1	14.6	14.4	19.5
Overall deficit	-2.7	-1.8	-2.6	-2.3	-0.2

Sources: Ministry of Finance and Economic Planning; and Fund staff projections.

1/ Taken from EBS/85/110 (May 1, 1985), with £2,139 million of revenue from the tax on special unnumbered import licenses classified as taxes on international transactions rather than nontax revenue.

2/ Assuming an official exchange rate of £ 90 = US\$1 and an auction that establishes an average exchange rate of £ 130 = US\$1 for the last four months of the year.

3/ Include additional payments to professional staff in respect of job upgrading.

4/ The 1985 figure includes £ 600 million of allowances reclassified as wages and salaries and £ 844 million of backpay to teachers. Wages and salaries as defined in the 1985 program and in previous years, amount to C 13,080 billion.

5/ Not including foreign assistance tied to projects or its counterpart expenditures, estimated at about 3.5 percent of GDP in 1986.

6/ Mainly provision for retrenchment.

7/ Using latest revised GDP figures.

service), additional incentives of £ 2.5 billion to professionals, and a doubling of capital expenditure in nominal terms (equivalent to a 30 percent growth in real terms). The resulting projected increase of the total expenditure/GDP ratio from 10.1 percent 1984 to 14.6 percent in 1985 was expected to be matched by an increase of the revenue/GDP ratio from 8.0 percent to 11.5 percent, as total revenue and grants were also to grow by 76 percent in nominal terms. The substantial revenue growth was to result mainly from (1) a large increase in revenue from taxes on international transactions, reflecting further exchange rate adjustments and larger volumes of imports as well as cocoa exports; and (2) a number of discretionary revenue measures that included, among others, large increases in excise duties on beer and cigarettes and a special tax on consumer goods imports (SILs). The authorities also began to take steps to significantly strengthen tax administration.

The provisional budget data for 1985 indicate that the fiscal outcome at the aggregate level was very close to the program targets, with slightly higher revenue and lower expenditure resulting in a marginally lower than programmed overall deficit, by some £ 1 billion. In their breakdown, however, major budget lines differed somewhat from earlier projections. Hence, both the import and excise duties were some 20 percent lower than projected as a result of sluggish imports (particularly under the SILs) and lower than projected sales of goods subject to excise duties. Nevertheless, most of this shortfall, which, to some extent, was already anticipated at the time of the mid-year review (EBS/85/211), was made up by large increases in taxes on income and property, and in nontax revenue. These reflected considerable success in improving tax collection from the self-employed, much higher company profits, and additional revenue from the road fund levy (£ 5 per gallon of petrol) and from higher public service fees and charges, introduced in the second half of 1985. While a shortfall (from earlier projections) in cocoa export duties of some £ 0.4 billion had been anticipated during the mid-year review, in line with an approximate 8,000 tons shortfall in cocoa exports, the actual cocoa export duties transferred to the budget turned out to be about £ 1 billion higher than projected in the original program. The difference of £ 1.4 billion, in addition to another £ 1.4 billion of unbudgeted retrenchment costs at the Cocoa Board, appear to explain a good part of the excess cocoa financing from the banking system registered at the end of 1985 (see below).

With regard to expenditure, lower levels of net lending were offset by higher levels of current expenditures, as outlays on emoluments and material supplies turned out to be somewhat higher than budgeted. Concerning current expenditure, the departure from program projections would have been larger, had the authorities not taken a number of expenditure saving measures in the area of subventions in the second half of 1985. Development expenditure (as recorded) during 1985, on the other hand, conformed to their program target. Finally, the financing of the marginally lower than programmed overall deficit itself differed from the original projections. While the ceiling of £ 2 billion on

financing of government by the domestic banking system (narrow coverage) was adhered to, part of the substantial shortfall in net foreign financing (¢ 3.5 billion rather than ¢ 5.4 billion) was made up by other domestic sources of financing, including the social security trust fund and the secondary banks. The latter contributed some ¢ 1.4 billion to the financing of the Government deficit in 1985. With the inclusion of all secondary banks in the monetary survey since 1986 such financing is now part of the banking system's net claims on government.

4. Balance of payments

Although encouraging, Ghana's overall export performance during 1985 was somewhat less buoyant than originally projected. Exports in U.S. dollar terms grew by some 12 percent (or about 4 percentage points less than expected), as lower prices, particularly for cocoa and timber, were more than offset by an increase in export volumes, by about 22 percent (Table 4). The latter reflected mostly increases in cocoa shipments, from 165,000 tons in 1984 to 192,000 tons in 1985, and timber export volumes, from less than 145,000 cubic meters in 1984 to almost 250,000 cubic meters in 1985, as well as increases in electricity and residual oil exports. Particularly disappointing, however, was the level of disbursements under long term loans (US\$134.8 million) which was less than half the amount initially programmed, and more than US\$20 million lower than in 1984. This development reflected delays in implementation of project and program aid from bilateral and multi-lateral donors, including the World Bank, and had resulted in a considerable backlog of undisbursed commitments by the end of 1985. Net inflows under medium-term loans and private capital also fell substantially below program projections. The shortfall in official foreign financing was almost matched by an equivalent shortfall in non-oil imports which were some US\$138 million below the program target and in nominal terms only 1 percent higher than in 1984. Accordingly, non-oil imports failed to grow in volume terms by comparison with 1984, which raised concern about the adequacy and timeliness of infrastructure rehabilitation.

Reflecting the above developments, the trade deficit in 1985 turned out to be much lower than projected, and reached only US\$36 million. Due to a significant shortfall in external grants and private unrequited transfers (mostly counterparts to SIL imports), the external current account deficit still reached US\$182 million, or 3.0 percent of GDP. While significantly below the program target of 5.9 percent of GDP, a reflection of the shortfall in concessional foreign financing, this deficit is, nevertheless, substantially larger than in 1984. However, the increase reflects mostly a larger deficit on the services account, and especially, lower unrequited transfers, rather than additional foreign assistance available for imports. Indications are that the overall balance of payments situation remained approximately on target in the first 9 months of 1985, but started to deteriorate in the last quarter of 1985, to reach an overall deficit of US\$98.1 million for the year as a whole.

Table 4. Ghana: Balance of Payments, 1983-86

(In millions of U.S. dollars)

	1983	1984	1985		1986
			Prog. 1/	Prov.	Proj.
Exports (f.o.b.)	439.6	565.9	654.0	632.4	723.6
Cocoa	(275.7)	(381.7)	(422.0)	(412.0)	(501.0)
Non cocoa	(163.9)	(184.2)	(232.0)	(220.4)	(222.6)
Imports (f.o.b.)	-570.2	-626.5	-835.0	-668.7	-786.4
Oil	(-161.1)	(-161.0)	(-227.0)	(-199.0)	(-121.7)
Non-oil	(-409.1)	(-465.5)	(-608.0)	(-469.7)	(-664.7)
Trade balance	<u>-130.6</u>	<u>-60.6</u>	<u>-181.0</u>	<u>-36.3</u>	<u>-62.8</u>
Services (net)	-279.5	-251.7	-314.0	-282.6	-344.8
Freight and insurance	(-30.2)	(-41.4)	(-57.0)	(-45.1)	(-50.3)
Investment income	(-82.0)	(-80.3)	(-121.0)	(-112.5)	(-114.1)
Profits and dividends (net)	(...)	(-0.3)	(...)	(-5.0)	(-5.0)
Interest payments	(-82.0)	(-80.0)	(-121.0)	(-107.5)	(-109.1)
Other services	(-167.3)	(-130.0)	(-136.0)	(-125.0)	(-180.4)
Unrequited transfers (net)	128.4	213.7	207.0	136.5	183.6
Government	(113.9)	(141.0)	(128.0)	(104.6)	(125.9)
Private 2/	(14.5)	(72.7)	(79.0) 2/	(31.9)	(57.7)
Current account balance	<u>-281.7</u>	<u>-98.6</u>	<u>-288.0</u>	<u>-182.4</u>	<u>-224.0</u>
Capital account balance	<u>154.6</u>	<u>-8.6</u>	<u>228.0</u>	<u>62.4</u>	<u>143.0</u>
Official capital (net)	67.4	87.8	215.0	32.1	117.6
Long-term loans (net)	37.1	131.0	223.0	109.8	169.9
Inflows	(84.4)	(156.7)	(256.0)	(134.8)	(207.8)
Of which: World Bank	(23.1)	(55.6)	(96.0)	(71.4)	(127.6)
Amortization	(-47.3)	(-25.7)	(-33.0)	(-25.0)	(-37.9)
Medium-term loans (net)	30.3	-42.0	-1.0	-70.3	(-41.1)
Inflows	(67.8)	(54.5)	(192.0)	(152.5)	(192.1)
Amortization	(-37.5)	(-96.5)	(-193.0)	(-222.8)	(-233.2)
Trust Fund	--	-1.2	-7.0	-7.4	-11.2
Private capital (net)	26.3	-11.7	23.0	5.8	25.4
Direct investment	(14.5)	(2.0)	(5.0)	(5.6)	(9.8)
Suppliers' credit	(11.8)	(-13.7)	(18.0)	(0.2)	(15.6)
Other	--	--	--	--	--
Nonmonetary short-term capital	55.0	-25.8	-10.0	-2.8	--
Monetary short-term capital	5.9	-58.9	--	27.3	--
Errors and omissions	-115.9	-13.8	--	21.9	--
Overall balance	<u>-243.0</u>	<u>-121.0</u>	<u>-60.0</u>	<u>-98.1</u>	<u>-81.0</u>
Financing	<u>243.0</u>	<u>121.0</u>	<u>60.0</u>	<u>98.1</u>	<u>81.0</u>
IMF (net)	258.7	213.7	120.0	121.8	15.9
Purchases	258.7	213.7	120.0	121.8	37.6
Repurchases	--	--	--	--	-21.5
Payments arrears	-33.7	-70.0	-60.0	-56.7	23.0
Other	18.0	-22.7	--	33.0	42.1

Sources: Data provided by the Ghanaian authorities; and staff projections.

1/ EBS/85/110.

2/ Includes reclassification of counterparts to SIL imports from other private capital (projected at US\$75 million for 1985).

Under the 1984/85 stand-by arrangement, Ghana was also to proceed with a phased cash reduction of the level of external payments arrears (US\$266.6 million) outstanding at end-June 1984 by US\$90 million over the period extending to end-December 1985. Ghana adhered throughout the period to this phased reduction. Since the actual cash reduction in calendar year 1984 turned out to be US\$4.8 million higher than programmed, the cumulative objective for 1984/85 was more than met by the actual reduction of US\$56.7 million in calendar year 1985, compared with the annual program target of US\$60 million.

5. Credit and monetary policies

The credit policy under the 1985 program aimed at supporting a targeted improvement in the overall balance of payments situation, and the goal to limit domestic inflation to at most 20 percent. At the same time, it aimed at providing an adequate level of financial resources to the productive sectors in order to sustain the economic recovery. To meet this dual objective, domestic bank financing (narrow coverage) of the government deficit was limited to no more than C 2 billion, which amounted to less than 16 percent of the overall expansion of net domestic assets programmed for 1985.

During the first three quarters of the year, the credit developments closely conformed to the program projections, as net domestic assets grew at the annual rate of around 40 percent envisaged under the program, and net claims on government remained just below the limits set (Table 5). The much lower-than-projected level of domestic inflation thus appeared to be explained by a positive shift of the real demand for money, and consequent decline in velocity, in addition to the somewhat higher real GDP growth. In this context, the medium-term objective of the interest rate policy pursued by the Ghanaian authorities since 1983 had been precisely to promote the mobilization of monetary deposits, in addition to improving the efficiency of credit allocation. During 1985, all deposit rates were raised by one percentage point in April, and by another one percentage point in September, bringing the 12 month deposit rate to 18 percent, while the lending rates were first raised by one percentage point and then by another half a percentage point. These adjustments followed an across-the-board increase of interest rates by two percentage points before the Board approval of the 1984/85 stand-by arrangement. As indicated earlier, in conjunction with the larger than expected decline of inflation, the above adjustments yielded positive real interest rates already in 1985, or somewhat earlier than envisaged under the program.

The large expansion of domestic liquidity that took place in the fourth quarter of 1985 and that led to the overshooting of the end-December indicative ceiling on overall net domestic assets, by C 7.84 billion, is fully reflected in the much larger than projected level of cocoa financing. While the claims on government (net) and credit to the rest of the economy remained on target, outstanding cocoa financing at the end of 1985 reached C 13.76 billion, against the program projection

Table 5. Ghana: Monetary Survey (narrow coverage), 1983-85 1/

	1983	1984	1985							
	Dec.	Dec.	March		June		Sept.		Dec.	
			Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual
(In billions of cedis)										
Net foreign assets	-16.68	-32.90	-38.28	-36.27	-37.29	-32.70	-34.48	-37.20	-36.46	-44.76
Net domestic assets	21.06	29.85	35.80	35.74	36.85	34.27	34.35	34.26	42.45	50.29
Claims on government (net)	21.06	22.82	23.82	23.75	24.22	24.18	24.52	24.48	24.82	24.82
Cocoa financing	0.52	3.48	5.60	5.19	4.80	3.88	—	0.46	5.66	13.76
Claims on rest of economy	3.85	7.80	10.64	10.22	12.09	11.86	14.09	13.84	16.23	16.00
Other items (net)	-2.83	-4.26	-4.26	-3.42	-4.26	-5.65	-4.26	-4.73	-4.26	-4.29
Revaluation account	16.16	34.71	34.71 <u>2/</u>	34.36	34.71 <u>2/</u>	33.92	34.71 <u>2/</u>	40.41	34.71 <u>2/</u>	43.48
Broad money	20.50	28.55	29.12	30.72	31.16	32.16	31.47	33.77	37.59	44.99
Counterpart of SDR allocations	1.58	3.11	3.11	3.11	3.11	3.33	3.11	3.70	3.11	4.02
(In annual percentage change)										
Net domestic credit	41.2	32.1	42.6	42.4	38.7	29.0	39.7	39.4	42.2	68.5
Broad money	38.1	39.3	31.3	38.5	35.8	40.1	32.7	42.4	31.7	57.6

Source: Bank of Ghana.

1/ Narrow coverage includes the Bank of Ghana and the three primary commercial banks.2/ Excluding impact of devaluations (after December 1984) on revaluation account, net foreign assets and counterpart to SDR allocations.

of £ 5.66 billion. The latter figure coincided with the anticipated financing of 50 percent of purchases of the 1985/86 cocoa crop, projected earlier at 200,000 tons. As it turned out, total purchases by the end of December 1985 amounted to about 65 percent of a total 1985/86 crop now estimated at 210,000 tons. Accordingly, some £ 2.07 billion of the excess cocoa financing of £ 8.10 billion above the program target can be readily explained by the need to finance during the last quarter of 1985 larger volumes of cocoa purchases than expected earlier. In addition, as explained above, another £ 2.80 billion appears to have resulted from the larger than programmed payments of cocoa duties to government and the need to finance the Cocoa Board's retrenchment costs in late 1985. The remainder--£ 3.23 billion--would reflect in part the anticipatory financing of cocoa purchases which were made in early 1986 (as reflected in the build-up of £2.20 billion of deposits by the Cocoa Board in the banking system by end-December 1985), and in part the financing of other additional cash needs late in 1985. As a result of the overrun in cocoa financing, the end-December 1985 over end-December 1984 growth in net domestic assets reached 68.5 percent, against the program objective of 42.2 percent, and similarly, the growth in broad money reached 57.6 percent, against the program objective of 31.7 percent. The evidence suggests that the build-up of liquidity in the last quarter of 1985, together with other factors, had begun to affect the balance of payments outcome as well as price inflation, which by year's end was running at almost 20 percent.

6. Compliance with 1985 performance criteria

The 1984/85 stand-by arrangement was subject to quantitative performance criteria on net domestic assets, net claims on government, cash reduction of external payments arrears, new nonconcessional external commitments with maturities of 1-12 years with a subceiling on maturities of 1-5 years, net disbursements of external loans of less than 1-year maturity other than trade-related credits, and bridging loans outstanding (Table 6).

All the performance criteria for end-March, end-June, and end-September 1985 were met. However, the indicative ceiling on the overall level of net domestic assets for end-December 1985 was overrun by a substantial margin on account of cocoa financing, for the reasons detailed above. The last purchase under the 1984/85 stand-by arrangement was made in mid-December, upon compliance with the performance criteria for end-September 1985. Throughout 1985, the performance criteria with regard to credit and cash reduction of external payment arrears turned out to be quite constraining, while the performance criteria with regard to the contraction of new debt were met with a large margin.

Table 6. Ghana: Implementation of 1985 Program; Performance Criteria, 1984-85

	<u>1984</u>		<u>1985</u>							
	<u>Dec.</u>		<u>March</u>		<u>June</u>		<u>Sept.</u>		<u>Dec.</u>	
	Actual		Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual (indicative)
<u>Outstanding (end of month, in billions of cedis) 1/</u>										
Net domestic assets										
Of which:	29.85		35.80 2/	35.74	36.85 2/	34.27	34.35 2/	34.26	42.45	50.29
net claims on government	22.82		23.82 2/	23.75	24.22 2/	24.18	24.52 2/	24.48	24.82	24.82
<u>Cumulative changes from end-December 1985</u>										
Net domestic assets			5.95	5.89	7.00	4.42	4.50	4.41	12.60	20.44
Of which			(1.00)	(0.93)	(1.40)	(1.36)	(1.70)	(1.66)	(2.00)	(2.00)
net claims on government										
<u>Cumulative net cash reductions (in millions of U.S. dollars) 2/</u>										
<u>1984</u>										
<u>Dec.</u>										
Prog. Actual										
External payments arrears 3/	30.0	34.8	45.0	50.0	60.0	71.0	75.0	86.6	90.0	91.6
<u>During August 1984-December 1985</u>										
<u>(In millions of U.S. dollars)</u>										
New nonconcessional external borrowings contracted or guaranteed by government			<u>Maximum</u>		<u>As of end-December 1985</u>					
Of maturity 1-12 years 4/			400.00 2/		212.9					
Of which: 1-5 years			(250.00) 2/		(212.9)					
External loans of less than 1-year maturity other than trade-related credits (net disbursements)			100.00 2/		27.0					
Bridging loans outstanding			75.00 2/		--					

1/ Narrow coverage of banking system.

2/ Performance criterion.

3/ Including liabilities relating to drawings under letters of credit.

4/ Including the Stanchart oil financing facility.

IV. Wage and Salary Developments in Early 1986

With the objective of making a significant step towards achieving an equilibrium exchange rate at an early stage in the medium-term adjustment program, the Ghanaian authorities devalued the cedi from $\text{¢ } 60 = \text{US\$1}$ to $\text{¢ } 90 = \text{US\$1}$ on January 10, 1986, in accordance with the recommendations made by the Fund staff mission in December 1985. At the same time, they announced a 28.6 percent increase of the daily minimum wage from $\text{¢ } 70$ to $\text{¢ } 90$, and an adjustment of civil service pay relativities with a view to restoring the ratio between top and bottom pay scales from about 2 to 1 to almost 6 to 1. These changes were supported by reductions in effective tax rates on personal incomes. Such a package had been recommended by the Fund staff mission in December 1985. The economy-wide increase of the minimum wage, which in 1985 was still only about 30 percent of its 1972 level in real terms, was thought justified by price and real sector developments, including increases in productivity that accompanied higher rates of capacity utilization. The additional incentives to the civil servants were thought necessary to increase efficiency of public administration. The Fund staff mission envisaged an overall increase of the civil service wage bill (excluding allowances) of some 70 percent relative to its 1985 base, 28.6 percent reflecting the increase in the minimum wage and 32 percent reflecting the adjustment of relativities. However, the wage and salary adjustment actually announced in January for the civil service would have generated much larger increases. Indeed, taking into account increases in salary-related allowances, the civil service wage bill in 1986 would have been around 147 percent higher than its 1985 base. Of particular concern too was the January announcement of guidelines providing for similar adjustments in the rest of the public sector and the private sector.

When they became aware of the likely adverse inflationary consequences both on the demand and supply sides of the announced new pay scales and reductions in personal tax rates, the Ghanaian authorities undertook to roll back part of the wage and salary increases. In negotiating revised pay scales, the Government was, however, forced to make a number of concessions, with the result that the civil service scales which came into effect on June 1, 1986 implied an annualized increase in the wage and salary bill (excluding allowances) of just below 100 percent from 1985, rather than the 70 percent previously agreed. At the new pay scale, including allowances, the average real wage in the civil service would have risen to about 46 percent of its level of 1972. In the face of considerable uncertainties with regard to import duty revenue and foreign financing that will be coming to the budget in the second part of 1986 (discussed below), the authorities decided, however, in early September 1986 to limit the payment of allowances to civil servants, resulting in a reduction of the projected government wage bill by $\text{¢ } 4.5$ billion, to $\text{¢ } 26.3$ billion. The above temporary measure will limit the growth of the wage bill in 1986, including allowances, to about 92 percent compared to its 1985 base. A remaining area of some uncertainty is the extent to which the wage and

salary increases granted in the civil service will feed through the rest of the public sector and the private sector. Preliminary indications are that wage and salary costs for public and private enterprises will be about 60 percent higher than in 1985.

V. The Economic and Financial Program for 1986/87

As indicated in the introduction, the proposed one-year program aims at rapidly offsetting the impact of slippages that occurred in late 1985 and early 1986, and thereby consolidating the significant progress made by the Ghanaian economy during the past three years. In addition to the pure stabilization aspects, the program also envisages the implementation of a number of structural measures, particularly with regard to the exchange rate system, tax and expenditure control policies, streamlining of the public enterprise sector, and retrenchment policy in the civil service. Several measures in the above areas will be implemented during 1986, while others will be formulated later in the year for implementation in the context of the EFF program envisaged for the 1987-89 period. The proposed economic and financial program for 1986/87 is detailed in the following subsections and summarized in Table 7.

1. Production and prices

For the third year in a row, real GDP growth is targeted to remain positive in 1986 and should reach at least 5.5 percent. Agricultural output is projected to grow at about 5 percent, while the cocoa sector contribution to GDP will reflect the 20 percent increase of the 1985/86 crop and the projected 7 percent further increase for the 1986/87 crop. In line with the first quarter outcome, a strong growth of manufacturing output of between 10 and 15 percent can be forecast for 1986. Price projections that incorporate the likely impact of exchange rate adjustments in 1986, increases in wages and salaries, as well as credit developments since late 1985, have necessitated a revision of the inflation target for 1986, in comparison with earlier expectations. In order not to impose excessive deflationary pressures on the domestic productive sector in the face of rising labor and import costs, the program envisages accommodating a 25 percent inflation of the GDP deflator. Measures in the areas of exchange rate and interest rate policies are expected to offset most of the negative impact that this slippage from the path towards price stability could have on relative prices and confidence. Particularly in view of the erosion in scarcity rents, inflation of the CPI in 1986 is unlikely to differ significantly from that of the GDP deflator. It could, however, turn out to be somewhat below 25 percent on average for 1986 if the foodcrops from mid-year are particularly abundant. Even when correcting for seasonality factors, actual inflation of the CPI during the first five months of the year was consistent with an annual inflation rate just above 25 percent, pointing to the need for a particularly cautious demand management policy for the remainder of the year.

Table 7. Ghana: Summary of the 1986/87 Economic and Financial Program

	1985 Actual	1986 Program
<u>Macroeconomic targets</u>	<u>(Percentage change)</u>	
Real GDP growth	5.8	5.5
CPI inflation	10.4	25.0
Nominal exchange rate, depreciation (average, in local currency terms)	51.5	81.8
Wages and salaries <u>1/</u>	187.3	92.0
Net domestic assets	68.2	27.9
Of which: net claims on Government	(12.5)	(11.0)
Overall balance of payments (US\$ million)	-98.1	-81.0
	<u>(In percent of GDP)</u>	
Overall fiscal deficit (-)	-2.3	-0.2
Of which: domestic bank financing	(0.9)	(0.7)
External current account deficit (-)	-3.0	-5.1

1/ Including allowances.

Principal policies of the program

a. Exchange rate and other external policies

Institution of a foreign exchange auction system, by September 19, 1986 for specified transactions. Unification in January 1987, when all transactions related to nonconsumer goods will be channeled through the auction market. Free issuance of "A" licenses to anybody wanting to import nonconsumer goods, and automatic access to auction market by October 1987. Commitments to limit contracting of government and government-guaranteed external loans on nonconcessional terms, and to reduce external payments arrears through net cash payments by US\$64 million during the period end-August 1986 to end-December 1986. Targets on net foreign assets of minus US\$855 million by end-September 1986, and minus US\$854 million by end-December 1986.

b. Pricing and incomes policies

Increase of cocoa producer price by 51 percent to ¢ 85,000 per ton (announced in May 1986). Increase in the minimum wage of 28.6 percent and an average increase of civil service salaries (including allowances) by 92.0 percent, taking into account ¢ 4.5 billion savings on allowances through the end of 1986.

Table 7. Ghana: Summary of the 1986/87 Economic and Financial Program
(Concluded)

c. Fiscal policies

A programmed overall government budget deficit for 1986 of 0.2 percent of GDP, reflecting the constraints imposed by foreign assistance to the budget, and the limit of ¢ 3 billion placed on domestic bank financing of the deficit. Beginning August 1, 1986 taxation of cash allowances paid to public and private sector employees. Conversion of windfall profit on petroleum into specific excise duty by October 15, 1986. Introduction of a 10 percent temporary import surcharge on July 1, 1986. Integration of project aid financed expenditures and their financing into the budget framework in 1987.

d. Monetary policies

Consistent with the overall balance of payments and inflation objectives, domestic credit is programmed to expand by ¢ 17.0 billion, of which ¢ 3 billion represents expansion of net claims on Government. In accordance with the objective of maintaining positive real interest rates in August 1986, deposit rates were increased across the board by 2 percentage points, with exception of 24-month deposit rate which was increased by 3 percentage points; regarding lending rates, similar increases of 2 to 3 percentage points will be effected on average by unifying all rates at the existing maximum of 23 percent. A key medium-term objective is to foster a significant recovery of the broad money/GDP ratio which should begin to show a moderate increase in 1987, as expected inflation declines once again. Limits of zero outstanding cocoa financing at end-September 1986 and of ¢ 14.6 billion by end-December 1986, as performance criteria.

e. Structural reforms

Rehabilitation of tax administration, doubling of personal income tax exemptions, reduction in number of income tax brackets and marginal tax rates and taxation of most cash allowances. Reform of the company income and sales taxes, and introduction of a higher luxury tax rate. Improved budgetary and expenditure control.

Further rationalization of the Cocoa Board's costs. Eventual attainment of a producer price which is 55-60 percent of the world price at an appropriate exchange rate.

Major restructuring of the state enterprise sector, including a program of mergers, joint ventures and divestitures (including sale and closure). By end-1986 selected enterprises will have prepared full financial accounts and corporate plans. Redeployment and management and manpower training programs to be implemented.

Program for the strengthening of public sector management to be drawn up with World Bank. Redeployment of 5 percent of the civil service (about 15,000 employees) at the beginning of 1987, and continuing annually through 1989.

2. The exchange and trade system

Ghana will be implementing fundamental changes in the exchange and trade system within the next few months that will result in a broadening of the access to the foreign exchange market and in the maintenance of a more flexible exchange rate policy. It should be noted that even before these changes there were virtually no quantitative restrictions on imports of goods into Ghana, only a restriction on importers' access to the official banking system for their foreign exchange needs. Thus, everybody who intended to import could obtain Special Import Licenses (SILs) that allowed import of unrestricted quantities of any goods (except for five goods on a negative list) as long as the importer paid the requisite taxes and raised the foreign exchange outside the official banking system. Only importers who brought goods into Ghana under the import licenses that were issued under the official import program for a limited range of specific goods had access to the official foreign exchange market, which effectively excluded most consumer goods and many other capital and intermediate goods from being financed through purchases of foreign exchange from the official banking system.

The range of goods for which foreign exchange can be obtained from the official banking system has been widened to include almost all capital and intermediate goods, leaving only the import of consumer goods to be covered with foreign exchange from unofficial sources. Thus, from October 1, most types of capital and intermediate goods can be imported into Ghana under an "A" license, which will be issued by the Ministry of Trade to everyone who wants to import these goods, and the foreign exchange regulations have been modified to ensure that foreign exchange to cover such imports can be purchased from the Bank of Ghana. Most consumer goods will still have to be imported under the SIL scheme and SIL importers must continue for a temporary period to obtain foreign exchange from outside the official banking system.

The most fundamental change in the exchange and trade system is the institution of an auction market for foreign exchange. The first auction was conducted on September 19. From that date and through the first full week of January 1987, Ghana will operate an official dual exchange rate system. Transactions designated for the first window will be settled at a fixed rate of ₵ 90 per U.S. dollar. Exchange proceeds eligible for surrender at the second window will be bought by the Bank of Ghana and the commercial banks at the marginal price established at the previous auction. Exchange sales for transactions designated for the second window will be conducted under the Dutch auction system under which the successful bidders will pay the price of their bid. Following the unification in the first full week of January, all foreign exchange transactions through the official banking system will be settled in accordance with the exchange rate determined in the auction.

However, as mentioned earlier, SIL importers will continue to have no access to the official banking system for a temporary period. It is recognized that the result of this restriction is to divert foreign

exchange resources away from the official banking system by sustaining a parallel market for foreign exchange outside this system, and the authorities have agreed to determine before the next review a timetable for when importers who utilize the SIL scheme will be allowed to bid in the auction for foreign exchange. Thus, Ghana will not have a truly market-determined unified exchange rate before the Bank of Ghana's two official foreign exchange windows have been merged and before all importers can bid for foreign exchange from the official banking system.

The transactions that will be settled at the fixed first window exchange rate for a temporary period are, on the supply side, surrender of foreign exchange earnings from export of cocoa and residual oil, and, on the demand side, demand for foreign exchange to cover imports of petroleum and essential drugs and debt service payments on official debt contracted before January 1, 1986. Supply and demand at the first window exchange are expected to balance and the Bank of Ghana should not be incurring losses from the operation of the dual exchange rate system.

The main aspects of the auction market are as follows. All foreign exchange receipts will be surrendered to the Bank of Ghana directly or through the commercial banks at the equilibrium rate struck in the most recent auction. The Bank of Ghana will determine how much to supply to the weekly auction taking into consideration its reserve management policy and demand for foreign exchange allocated outside the auction. The latter comprises mainly demand for foreign exchange by the central government and for petroleum imports. As far as the criteria for determining access to the auction is concerned, holders of "A" licenses and of specific licenses issued under the 1985 and 1986 annual import programs can bid for foreign exchange to settle a maturing letter of credit or other due payments relating to imports. They can also bid for foreign exchange to open letters of credit, in which case the bid must be accompanied by a pro forma invoice and the foreign exchange proceeds will be placed in a blocked account with a commercial bank until the letter of credit matures. Bids for foreign exchange to settle all other approved foreign exchange transactions will also be eligible for participation in the auction.

3. Fiscal policies

A draft 1986 budget was prepared in March/April 1986, well into the fiscal year. However, this was based upon an assumed increase in wages and salaries in the civil service of 70 percent. As outlined above, the pay scales that were eventually agreed with labor representatives, and which came into effect June 1, 1986, implied larger increases in wages and salaries than earlier envisaged. It also proved impossible to recover overpayments made at the beginning of the year. To take account of this, a revised 1986 budget was prepared in mid-June. As already indicated, further adjustments to the budget were made in early September in response to a projected shortfall in domestic and external resources.

a. The 1986 budget

The 1986 program provides for an overall deficit of the Central Government (excluding foreign assistance tied to projects and its counterpart expenditures) of ¢ 0.9 billion, or 0.2 percent of GDP, compared to 2.3 percent in 1985. The deficit has been constrained by limiting foreign financing to the budget to the level of financing that has already been firmly committed, and by a limit of ¢ 3 billion that has been placed upon the financing of the deficit by the domestic banking system, including secondary banks. As regards foreign assistance, under the terms of the external oil financing facility with the Standard Chartered Bank (Stanchart) which links drawings under this facility to liftings of crude oil, the substantial decline in world oil prices results in net repayments for 1986. This is the main reason why net foreign borrowing, including non-oil foreign assistance, is also negative. Both revenue and expenditure are budgeted to be considerably higher than in 1985. Total revenue and grants are expected to increase by 111 percent, implying a rise from 12.1 percent of GDP in 1985 to 19.3 percent of GDP in 1986. Total expenditure and net lending is expected to increase by 79 percent from 14.4 percent of GDP to 19.5 percent.

The improved revenue performance can be explained by a number of factors. Increased wages and salaries in both the public and private sectors will lead to higher personal tax collections, despite reductions in effective tax rates, resulting from the lower marginal tax rates and higher tax exemptions that came into effect from January 1. In addition, since August 1, a number of allowances which were previously paid free of tax, have been subject to tax. Also, a major start has been made on the rehabilitation of tax administration, with particular attention being paid to improving compliance with the company income tax. Data for the first half of 1986 point to a possible doubling in company tax collections for the year as a whole compared to 1985. The large increase in revenue from taxes on domestic goods and services in part reflects higher excise duty rates. But the principal source of additional revenue is the windfall profit on petroleum products resulting from the fall in world oil prices. Taking into account a ¢ 10 per gallon increase in petroleum prices effective end-June (prices having been reduced by ¢ 10 per gallon in March), this windfall profit should amount to at least ¢ 5 billion. Part of this profit is to be converted into a specific excise duty on petroleum by October 15, 1986, so as to protect this major new revenue source in the event of an increase in world oil prices. However, the size of the excise duty will be determined after provision of about ¢ 2 billion for the capitalization needs of the Ghana National Petroleum Corporation in 1987.

Taxes on imports will benefit from improved import volumes, the adjustment of the unitary exchange rate at the beginning of 1986, and the introduction of the foreign exchange auction in September (which it has been assumed will result in an average exchange rate of ¢ 99 = US\$1 for the year). In addition, a 10 percent temporary surcharge on non-oil

imports was introduced on July 1; this is expected to yield \$3.1 billion. Transfers from the Cocoa Board to the budget of some C 17.09 billion of cocoa revenue, or more than twice their 1985 level, are provided for, reflecting a larger crop, a higher realized export world price, and the exchange rate adjustment. Lastly, nontax revenues are also expected to be markedly higher than in 1985, mainly the result of larger projected aid disbursements in the form of grants to the budget.

As regards expenditure, the increase in civil service wages and salaries will contribute to a significant increase in current expenditure. While part of this increase is to be met from increased revenue, there have been cuts in other current expenditure. In particular, the provision for expenditure on transfers to a wide range of public bodies was excessive and will be cut back. Further reductions are planned for 1987, the aim being that the whole of the permanent increase in expenditure on wages and salaries implied by the new pay scales--after allowing for the temporary excess payments in the first part of 1986--will be offset by permanent reductions in other current expenditure. The other major source of increased current expenditure is interest on external debt, partly reflecting the exchange rate adjustment, but also obligations from the end of 1985 which were carried over into 1986. Because of the above adjustments to revenue and current expenditure, the capital expenditure program for 1986 agreed with the World Bank has remained intact. However, the Government has identified C 2.3 billion of noncore capital expenditures--relating to nonpriority irrigation and construction projects, and expenditures on information services and administration--that will not be committed in the event of a shortfall in transfers from the cocoa sector not compensated for by higher noncocoa revenues. The Cocoa Board's commitment to repay all outstanding cocoa financing by the end of September could prevent it from transferring the full amount of C 17.09 billion of cocoa revenue to the budget. A modest C 1 billion has been allocated to a "special efficiency" program of redeployment and retraining, which will have started only in late 1986.

b. The 1987 budget

The 1987 budget, which should be in place at the start of the fiscal year, will attempt to consolidate the stabilization gains that should be made in the second half of 1986. The deficit will again be constrained by available financing, with concessional foreign assistance to the budget being limited by the extent to which the additional capital expenditure it would finance can be justified in terms of a medium-term structural adjustment program. On the revenue side, it is expected that structural reforms combined with administrative improvements will continue to generate increased tax collections. Even when including all initially granted allowances, real earnings of civil servants in 1986 would still have been less than 50 percent of their 1972 level, and a further increase in wages and salaries, in real terms, is envisaged for 1987. However, a continuing effort will be made to contain the growth of other current expenditure. As the medium-term

development program discussed with the World Bank requires a significant increase in capital expenditure, the integration of project aid financing and its counterpart expenditure into the budget framework will be effected from 1987.

4. Other external policies

Ghana's exports and imports are expected to increase significantly during 1986, both in volume and U.S. dollar terms. The projected overall 7 percent growth in export volume reflects mostly increases in cocoa shipments, from 192,000 tons in 1985 to 214,000 tons in 1986, and in timber, from some 250,000 cubic meters to almost 325,000 cubic meters. The above translates into a projected increase of total exports in U.S. dollar terms by more than 14 percent, as Ghana's realized export prices for cocoa in 1986 will be more favorable than in 1985, in spite of weaker world market prices for cocoa since the beginning of the year. Ghana sold a large part of its crop forward in late 1985 at prices quoted mainly in pound sterling, and has thus benefitted from the decline in the value of the U.S. dollar which has occurred since then.

Non-oil imports are projected to rise substantially during 1986, by some 27.7 percent in volume terms from 1985, a development which mostly reflects the anticipated large increase in disbursements of foreign aid tied to particular imports of goods. It may be noted that the implied volume of imports would be only modestly higher than in 1981, just a year before the tightening of Ghana's foreign exchange constraint became particularly severe. Mostly because of the substantial decline in crude oil prices, Ghana's imports in 1986 will increase by only 17.6 percent in U.S. dollar terms, resulting in a trade balance deficit of only US\$63 million.

While there will be little increase in interest payments during 1986, other services outflows are expected to rise significantly, reflecting in part larger payments for technical assistance. Accordingly, and notwithstanding the projected 20 percent increase in foreign grants, the external current account deficit will be above its 1985 level, and reach some 5.1 percent of GDP. While Fund purchases, and additional nonofficial sources last year provided most of the financing, drawings under official long-term loans on concessional terms are expected to finance a large part of the external current account deficit in 1986. They are projected to increase by more than 50 percent from 1985, to some US\$207.8 million. Gross inflows of official medium-term loans will also increase substantially, in spite of the decline in oil financing, reflecting mostly larger disbursements to the export sectors.

The overall balance of payments deficit for 1986 is projected to amount to US\$81 million, compared to US\$98.1 million in 1985. The overall deficit in 1986 is being financed through net purchases from the Fund equivalent to US\$16.1 million, through an increase in arrears of US\$23.2 million, and through a net increase in other liabilities of US\$52.7 million, reflecting mainly borrowing by the Bank of Ghana from

commercial banks. While the net foreign assets position of the Bank of Ghana will deteriorate significantly for the year as a whole, this reflects developments during the first eight months when arrears increased by US\$111 million and net foreign assets fell by US\$128 million. From end-August to end-December 1986, arrears are programmed to decline by US\$87 million (US\$23 million through rescheduling and US\$64 million through cash payments) and the net foreign assets position is targeted to improve by US\$47 million. An improvement in net foreign assets by US\$37 million is a performance criterion.

During the mission that visited Accra in July, it was discovered that gross reserves had been significantly overestimated because cedi-denominated claims by the Bank of Ghana on the central government and on other public entities, that had arisen in instances where foreign borrowing by these entities had been passed through the books of the Bank of Ghana, had been recorded as foreign assets. The inclusion of a performance criterion relating to net foreign assets of the Bank of Ghana reflects the concern to safeguard the Bank of Ghana's reserve position and build up reserves, inter alia, to help meet the large repurchases from the Fund falling due in the coming years.

5. Monetary and credit policy

The main thrust of monetary and credit policy during 1986 will be to assist the stabilization and balance of payment objectives of the program, as well as to support a smooth operation of the auction market for foreign exchange. As was the case under the previous two programs, the largest part of the allowable credit expansion will go to the productive sectors, and the central government's share in the overall increase of net domestic assets in 1986 will be only 16 percent.

To ensure a more comprehensive monitoring of monetary and credit developments, the coverage of monetary data has been considerably broadened in 1986 and now includes, in addition to the Bank of Ghana and the three primary commercial banks, all the other seven secondary banks (of which three are development banks). Several of these banks have recently benefitted from long-term loans (foreign and domestic) as well as equity injections, and are likely to play a more significant role in the intermediation of term resources to support the rehabilitation of the Ghanaian economy. It should be emphasized, however, that the assessment of monetary and credit developments of the past two years, when expressed in growth terms, appears to be broadly invariant to the choice of coverage (Table 8).

A key medium-term objective of the authorities is to foster a significant recovery of the broad money/GDP ratio, expected to accompany the mobilization of private domestic savings. The attainment of this objective will also be essential to enable Ghana to meet its large external obligations of coming years without credit asphyxia. Even when making proper adjustment for the build-up of temporary deposits in the banking system by the Cocoa Board in late 1985, some progress in that

Table 8. Ghana: Monetary Survey (broad coverage), 1984-86 1/

	<u>1984</u> Dec.	<u>1985</u> Dec.	<u>1986</u> March	<u>1986 program</u>		
				June Prov.	Sept.	Dec.
(In billions of cedis; end of period)						
Net foreign assets <u>2/</u>	-31.44	-48.70	-59.40	-65.36	-57.70	-62.61
Net domestic assets	39.88	67.08	77.50	87.83	75.54 <u>3/</u>	85.80 <u>3/</u>
Net claims on government	24.17	27.18	32.57	37.90	36.18 <u>3/</u>	30.18 <u>3/</u>
Cocoa financing	3.58	13.54	14.76	11.45	-- <u>3/</u>	14.60 <u>3/</u>
Credit to the rest of the economy	13.72	25.98	28.46	34.69	40.33	43.00
Other items, net	-1.59	0.38	1.71	3.79	0.81	0.81
Long-term foreign liabilities of development banks <u>4/</u>	--	--	...	...	-1.78	-2.79
Revaluation account <u>2/</u>	29.93	41.88	49.97	50.91	49.97	49.97
Broad money	35.27	56.24	61.86	66.70	61.59	66.94
Money	27.40	43.95	48.02	50.79	...	...
Quasi-money	7.87	12.29	13.84	15.91	...	...
Counterpart to SDRs allocations <u>2/</u>	3.11	4.02	6.22	6.68	6.22	6.22
(Annual percentage changes)						
Net domestic assets	33.0	68.2	...	...	...	27.9
Net claims on government	10.5	12.5	...	...	...	11.0
Broad money	42.0	59.5	...	...	...	19.0

Sources: Bank of Ghana; and Fund staff projections.

1/ Including primary and secondary banks.

2/ Excluding revaluation of foreign assets and liabilities after March 1986.

3/ Performance criterion.

4/ From January 1, 1986; note also that revaluation of these specific liabilities during 1986 will have its counterpart in other items net.

direction was made during 1985. In that year, the broad money/GDP ratio (broad coverage of banking system) recovered to about 17 percent, compared to 13 percent in 1984, and to an historical average of about 25 percent during the 1965-79 period. The decline in velocity during 1985 appeared to reflect mostly the impact of the sharp decline of inflation on confidence in the domestic currency, and the incentives provided by positive real interest rates.

In view of the upward revision in projected inflation for 1986, and to limit the erosion of real interest rates, the authorities have increased, in August 1986, all deposit rates by two percentage points, which will bring the 12 month deposit rate to 20 percent; in addition the 24-month deposit rate was raised by three percentage points to 22 percent. With regard to lending rates, similar increases of between 2 and 3 percentage points have been effected on average by unifying all rates at the existing maximum of 23 percent. Until now, preferential rates of 18.5 and 20.5 percent applied to the agricultural and export sectors. But these productive sectors are now benefitting from better price incentives, partly as a result of the devaluations, and from the improved infrastructure, so that the interest rate subsidy no longer appears necessary. At the same time, the above unification is expected, through its impact on the supply side, to continue promoting the channeling of domestic financial resources to these same sectors. A lowering of reserve requirements on term, relative to current, deposits will also be effected in the context of the 1986 program, in order to facilitate medium and long-term lending by banks through a better equalization of the effective cost of term versus current resources.

In spite of the action taken by the authorities as regards interest rates, it has not been possible to program a further decline of velocity for 1986, in part because of the likely impact of the projected higher rate of inflation on the willingness of economic agents to hold on to narrow money, including currency. Hence, the growth of broad money that is consistent with the program targets of limiting inflation to at most 25 percent and of attaining the overall balance of payments target for 1986 as a whole, is projected at no more than 19.0 percent. As a result, the overall expansion of net domestic assets over calendar year 1986 will be limited to C 18.72 billion, or 27.9 percent, of which C 3.00 billion will go to the financing of the central government deficit, implying a growth of net claims on government of only 11.0 percent from 1985. Reflecting the large outstanding debt of the Cocoa Board at the end of 1985, the increase in cocoa financing by the end of 1986 will amount to only C 1.06 billion. The projected outstanding cocoa financing of C 14.60 billion at end-December 1986 has been derived from a detailed cashflow model of the Cocoa Board's operations in the year, that includes provisions for (1) the financing of about 65 percent of the projected 1986/87 crop of 225,000 tons; and (2) operating cash needs of C 2.2 billion in the fourth quarter of 1986, of which C 0.5 billion is to cover retrenchment costs at the Cocoa Board. Allowing additional domestic credit for the projected disbursement of US\$21.5 million of credit lines, from the African Development

Bank and the EEC, the expansion of domestic credit to the rest of the economy is programmed to reach C 17.02 billion (or 65.5 percent), compared with C 12.26 billion (or 89.4 percent) in 1985. While the increase for the year as a whole is substantial, there is a declining rate of expansion as the year progresses. Thus, credit expansion in the second half of 1986 will average 53.6 percent on an annual basis, compared with 78.3 percent on an annual basis in the first half of the year. For the last quarter of 1986, i.e., the period covered by the proposed financial program, the credit expansion is targeted to be further reduced to 29.2 percent on an annual basis, thereby ensuring some re-absorption of any excess credit that occurred in earlier months. It should be indicated that most of the envisaged credit expansion to the rest of the economy is for the productive sectors, including manufacturing where capacity utilization has been rising substantially. In addition to having to meet the higher wage cost indicated above, these sectors will require additional cedi financing for imports in the face of an estimated 82 percent average depreciation of the cedi (in local currency terms) during 1986.

A number of negative developments in early 1986 have significantly worsened the usually tight liquidity situation of the central government in the first part of the year. In particular, unexpected delays occurred in the disbursement of secured foreign financing ^{1/} and in cocoa shipments, the latter due to foreign buyers postponing the lifting of cocoa because of the significant decline in spot prices. Furthermore, no cash receipts accrued from the windfall profit on petroleum in the first part of 1986 as the retroactive reduction of Nigerian crude oil prices to January 1986 will affect oil payments only in the second part of the year. Finally, the excess wage and salary payments of early 1986 detailed above had to be financed at a time when new revenue measures had not yet been taken. As a result, net claims on government increased by more than C 5 billion in the first quarter of 1986 and by another C 5 billion in the second quarter. The authorities intend, nevertheless, to limit bank financing of the central government for the year as a whole to at most C 3 billion. They are confident that the cashflow situation in the remainder of the year, taking into account the new revenue measures and the savings on wages, will permit them to reduce net claims on government by about C 2 billion in the third quarter and by another C 6 billion in the fourth quarter; this will bring outstanding net claims on government down to C 36.18 billion by end-September 1986, and to C 30.18 billion by end-December 1986, compared with C 27.18 billion at end-December 1985.

^{1/} These delays appeared to reflect administrative bottlenecks and time-lags in the generation of counterpart funds rather than serious problems with the absorption capacity in Ghana or the ability of donors to disburse. A rapid acceleration in disbursements, particularly from the World Bank, is reported to have taken place since June.

By the end of June 1986, outstanding cocoa financing had declined by more than £ 3 billion from its end-March level of £ 14.76 billion. While this reduction was less than earlier expected, the authorities remain confident that the program target of a reduction to zero by end-September (which coincides with the end of the 1985/86 crop year) can still be reached. During the negotiations on the proposed program, the Fund mission expressed concern as regards the ability of the Cocoa Board to fully repay the banking system by end-September, and at the same time transfer to the Government the full amount of the projected £ 17.09 billion surplus on cocoa. The problem is related to the unusually high level of cocoa financing at end-December 1985, as discussed above, but some uncertainty remains as to the size of the Cocoa Board's cash resources at the end of 1985, beyond the £ 2.2 billion of deposits identified in the banking system. Accordingly, the staff has accepted the authorities' assurances that the full repayment to the banking system will be made, provided that, as indicated earlier, contingent expenditure cuts for an amount of £ 2.3 billion are identified in the budget for implementation in the event of a shortfall in revenue. Outstanding cocoa financing of zero at end-September and of no more than £ 14.60 at end-December, 1986 have also been made performance criteria under the program. Reflecting mostly the timing of government and cocoa financing, overall net domestic assets, which are estimated to have reached £ 87.83 billion by end-June, are programmed to decline to £ 75.54 billion by end-September and to increase to £ 85.80 billion by end-December 1986.

6. Structural reforms

In the context of a possible extended arrangement with the Fund and the proposed World Bank Structural Adjustment Credit, the Ghanaian authorities have embarked upon a program of structural and institutional reforms. Particular emphasis is to be placed on tax reform, budgeting and expenditure control, the cocoa sector, state enterprises, and public sector management.

a. Tax reform

The authorities have indicated their intention to implement a number of the major recommendations made by a 1985 Fund technical assistance mission. A significant beginning has already been made. The recent doubling of personal income tax exemptions, the reduction in the number of income tax brackets and marginal tax rates, and the partial taxation of cash allowances are in line with Fund recommendations. Similarly, the rehabilitation of the tax administration has begun. Efforts have concentrated on what was identified as one of the weakest areas, the operation of the company income tax, and the benefits are already emerging (see above). For the medium-term, emphasis is to be placed upon further administrative improvements, since these are likely to be the key to mobilizing additional revenue. Shortcomings with respect to staffing, conditions of service, and the legal aspects of tax administration will be addressed. The authorities are committed to

further structural reforms of the tax system over the next three years, although precise details and timetable, have yet to be confirmed. However, discussions with the authorities have focused on the following concerns. The company income tax does not provide appropriate incentives to the productive sector of the economy. In particular, capital allowances are not adjusted to take account of inflation, which is a disincentive to investment, and the promotional characteristics of the tax (i.e., the lower tax rate and more generous capital and investment allowances associated with particular favored activities) are not well integrated with those of the investment code. The sales tax, which is characterized by numerous exemptions, should be developed into a major revenue source. This would result mainly from improving its administration but could be enhanced by an extension of the base, an increase in the standard rate (which would mainly compensate for the elimination of many small excise duties), and the introduction of a higher luxury rate. As regards excise duties, these ought to be restricted to beer, cigarettes and petroleum (see above). The basic import tariff structure appears appropriate, although its ultimate form must reflect an appropriate pattern of protection under a more liberal trade regime. The sales tax on imports should be the same as that on domestically produced substitutes, so that the sales tax does not influence the protective structure. For many years, the cocoa export duty has been a major revenue source. However, this tax constitutes a major disincentive to cocoa production. As other revenue sources grow in importance, the effective income tax implied by the cocoa export duty should be reduced and ultimately transformed into an agricultural income tax. The latter will inevitably take time to achieve, and cannot be expected within the time horizon of a medium-term adjustment program. But the authorities are taking the reform of cocoa taxation seriously, and are prepared to take significant preparatory steps to ease the transition between tax regimes.

b. Budgeting and expenditure control

The current budgeting system has a number of deficiencies, including incomplete coverage, insufficient financial planning, and inadequate control and monitoring. The clearest adverse consequence of these deficiencies has been the delay in preparing the annual budget. The Government requested Fund technical assistance to review budgetary procedures, including expenditure monitoring and control, and a mission visited Ghana in July 1986. The recommendations of this mission are in the process of being finalized. They have been designed to facilitate not only the implementation of the Economic Recovery Program, but also the implementation of medium-term structural adjustment programs supported by Fund and World Bank arrangements. However, the authorities will not be taking any decisions in this area until after having considered the Fund's recommendations.

c. The cocoa sector

The rehabilitation of the cocoa sector is essential to the growth objectives of the Economic Recovery Program. It is therefore important that cocoa production be increased through improved producer incentives and support, and that the share of the world market price absorbed by the Cocoa Board be reduced. The cocoa producer price has been increased sevenfold over the last four years, but is still half the price received by cocoa farmers in Côte d'Ivoire, at the parallel exchange rate. Thus there remains a powerful incentive to smuggle. The World Bank has provisionally suggested that a producer price of 55-60 percent of the world price at an appropriate exchange rate, as compared with the current 30 percent, would be appropriate. The reform of cocoa taxation would both facilitate an increase in the producer price and provide incentives for planting and replanting. As regards the operations of the Cocoa Board, preliminary studies by the World Bank suggest that each of its three major activities--the provision of essential services to farmers, production, and marketing--gives cause for concern, and that a number of inefficient or low priority activities could be dispensed with. Further rationalization of the Cocoa Board's costs remains an important objective for the medium-term.

d. State enterprises

As part of the Economic Recovery Program, the government is to undertake a major restructuring of the state enterprise sector. The principal objective of the reform program is to have in place commercially oriented and financially self-sufficient state enterprises. Government financial support is to be limited to that necessary to support priority social and other noncommercial objectives and rehabilitation projects essential to the Economic Recovery Program. To this end, enterprises are to be subject to increased competition and market discipline. Public monopolies will continue to exist only to the extent that the nature of the industry dictates that they are unavoidable (e.g., as in the case of utilities). Management of many enterprises will be given autonomy in respect of pricing, investment, and employment decisions. A program of mergers, joint ventures, and divestitures (including sale and closure) will also be put into effect. A timetable for decisions and implementation has been drawn up. By the end of 1986 all enterprises covered by the restructuring program will have prepared full financial accounts and corporate plans, and those enterprises to be given autonomy, merged, sold or closed will have been identified. The financial accounts will also serve as a basis to monitor, from 1987 on, the resources provided by the central government and the banking system in the form of transfers or credit. A redeployment program will commence and management and manpower training programs will be introduced. However, to date progress has been limited to the formulation of a policy statement on state enterprises, the creation of an effective State Enterprises Commission, and the identification of priority state enterprises to be monitored by the Commission.

e. Public sector management

In conjunction with the World Bank a program for the strengthening of public sector management is being drawn up. Particular attention is focused on the managerial aspects of the implementation of the Economic Recovery Program, including policy analysis and review, public investment appraisal, aid negotiation and management, the monitoring of project implementation and debt management. The program also covers redeployment in the civil service. The Government originally announced a plan to redeploy 5 percent of the work force (about 15,000 employees) in 1986. However, the indications are that the full implementation of this plan will be delayed, and only a modest provision of C 1 billion for redeployment under the special efficiency program has been made in the 1986 budget. Wider aspects of civil service employment, pay, and conditions are also to be addressed, with a view to ensuring that the government can attract suitably qualified and motivated manpower.

7. Medium-term outlook and capacity to service obligations to the Fund

Ghana's balance of payments and debt situation during 1987-89 will remain very difficult. This assessment reflects in part the substantial repurchases to the Fund falling due in the period, which on an annual basis will average some SDR 155 million. Detailed medium-term projections for the period 1987-91 indicate, nevertheless, that Ghana should be able to meet its external obligations of the next three years, and thereafter reduce its recourse to balance of payments financing, without seriously compromising its growth objectives (Tables 9 and 10). Success in this endeavor will, however, require the proper policy environment, and in particular: (a) the continuation of active stabilization policies that will progressively reduce domestic inflation to the level of Ghana's trading partners, and promote domestic savings; (b) continued liberalization of the exchange and trade system aimed at enhancing Ghana's competitive position, encouraging remittances and capital inflows, and allocating scarce foreign exchange resources to the most efficient users; and (c) a redefinition of the role and size of the public sector that will be limited to a number of strategic industries and the rehabilitation of the economic and social infrastructure, and leave ample room to private initiative.

For the foreseeable future, the recovery of the cocoa sector will remain critical to export growth. The larger-than-expected supply response in 1985/86, and a revised and somewhat more optimistic World Bank assessment as regards the rejuvenation of plantations, allows cautiously more favorable export volume projections than at the time of the second review of the 1984/85 program (EBS/88/211). Accordingly, cocoa exports are expected to reach some 245,000 tons by 1988 and further increase to 290,000 tons by 1991. However, reflecting the current excess supply situation on the world markets, Ghana's export price for cocoa is projected to decline substantially in 1987 compared to 1986, by as much as US\$300 per ton, to just above US\$2,000 per ton; thereafter, the U.S. dollar price for cocoa is expected to increase only

Table 9. Ghana: Medium-Term Balance of Payments, 1985-91

(In millions of U.S. dollars)

	1985	1986	1987	1988	1989	1990	1991
Exports (f.o.b.)	632	724	778	882	965	1,069	1,176
Cocoa	(412)	(501)	(472)	(519)	(559)	(608)	(659)
Noncocoa	(220)	(223)	(306)	(363)	(406)	(461)	(517)
Imports (f.o.b.)	-668	-787	-860	-960	-1,037	-1,120	-1,209
Trade balance	-36	-63	-82	-78	-72	-51	-33
Services (net)	-283	-344	-395	-337	-462	-507	-525
Freight and insurance	-45	-50	-50	-56	-61	-65	-70
Investment income	-113	-114	-142	-156	-171	-182	-188
Profits and dividends (net)	-5	-5	-6	-7	-8	-9	-10
Interest payments <u>1/</u> <u>2/</u>	-108	-109	-136	-149	-163	-173	-178
Other services	-125	-180	-203	-225	-230	-260	-267
Unrequited transfers (net)	137	183	254	273	292	312	333
Official	105	126	144	153	162	172	182
Private <u>3/</u>	32	57	110	120	130	140	150
Current account balance <u>3/</u>	-182	-224	-223	-242	-242	-246	-226
Capital account (net) <u>3/</u>	63	143	298	325	315	263	236
Official (net)	33	118	258	273	255	196	159
Long-term, loans (net)	110	170	198	217	230	208	198
Drawings	135	208	237	251	265	280	297
Amortization <u>2/</u>	-25	-38	-39	-34	-35	-72	-99
Medium-term loans (net)	-70	-41	70	66	35	-9	-39
Drawings	153	192	200	210	210	200	170
Amortization	-223	-233	-130	-144	-175	-209	-209
Trust Fund repayment	-7	-11	-10	-10	-10	-3	--
Private capital (net) <u>3/</u>	6	25	40	52	60	67	77
Direct investment	6	10	25	40	50	60	70
Suppliers' credits	--	16	15	12	10	7	7
Drawings	5	25	30	40	45	50	55
Amortization	-5	-9	-15	-28	-35	-43	-48
Other <u>3/</u>	--	--	--	--	--	--	--
Nonmonetary short-term capital	-3	--	--	--	--	--	--
Monetary short-term capital	27	--	--	--	--	--	--
Errors and omissions	22	--	--	--	--	--	--
Overall balance	-98	-81	75	83	73	17	10
Financing	98	81	...	...	...	...	...
Use of Fund resources (net)	122	16	...	...	...	...	...
Purchases	122	38	59	...	...	...	...
Repurchases	--	-22	-161	-235	-161	-94	-62
Payments arrears reduction	-57	23	-66	-66	-66	--	--
Other (including Stanchart 1986)	33	42	-47	-33	--	--	--
Financing gap	--	--	140	251	154	77	52
Memorandum items:							
External current account (in percent of GDP)	-3.0	-5.1	-6.4	-6.3	-5.7	-5.4	-4.6
Gross official borrowing (including financing gap)	287	400	577	713	629	557	520

Sources: Data provided by the Ghanaian authorities; and Fund staff projections.

1/ Including private suppliers' credits, and oil credits.

2/ Includes servicing on residual financing.

3/ The 1985 figures reflect reclassification for the medium-term projections of counterparts to imports under SIL as private unrequited transfer rather than private capital inflow.

Table 10. Ghana: Government and Government-Guaranteed
External Debt Projections, 1985-91 1/

(In millions of U.S. dollars)

	1985	1986	1987	1988	1989	1990	1991
I. Financial flows							
A. Exports of goods and nonfactor services	669	768	826	935	1,021	1,130	1,241
B. New borrowing <u>2/</u>	287	400	577	713	629	557	520
Of which: oil credits <u>3/</u>	116	57	50	50	40	30	—
C. Fund purchases	122	38	59	...	...	...	...
II. Service on:							
D. Debt outstanding (12/31/85)	293	320	140	126	111	95	81
Interest	38	39	34	31	28	25	24
Of which: oil credits	9	4	—	—	—	—	—
Amortization	248	270	96	86	73	67	57
Medium-term	223	232	57	52	38	29	19
Of which: oil credits	170	171	—	—	—	—	—
Long-term	25	38	39	34	35	38	39
Trust Fund	7	11	10	10	10	3	—
E. New Borrowing	—	8	163	189	222	317	367
Interest <u>2/</u>	...	6	43	63	85	102	116
Of which: oil credits	...	3	5	5	5	4	2
Amortization <u>2/</u> <u>4/</u>	...	2	120	126	137	215	251
Medium-term	...	2	120	126	137	181	190
Of which: oil credits	...	2	57	50	50	40	30
Long-term	...	—	—	—	—	34	61
F. Fund	52	77	217	286	206	133	93
Charges	5	55	56	51	45	39	31
Repurchases	—	22	161	235	161	94	62
G. Total (D + E + F)	345	405	520	601	539	545	541
H. Debt service ratio (in percent of exports of goods and nonfactor services) <u>2/</u>							
Including Fund charges and repurchases (G/A)	51.6	52.5	62.9	64.4	52.8	48.2	43.6
Excluding Fund charges and repurchases (G-F/A)	43.8	42.5	36.6	33.7	32.7	36.5	36.1

Memorandum items:

1. Total line G	345	405	520	601	539	545	541
2. Private suppliers' credit	22	19	18	33	41	49	55
Interest	17	10	3	5	6	7	8
Amortization	5	9	15	28	35	43	48
3. Total 1+2	367	424	538	634	580	594	597
4. Total debt service in balance of payments <u>5/</u>	367	424	538	634	580	594	597

Sources: Data provided by the Ghanaian authorities; and Fund staff projections.

1/ Debt flows in the table differ from balance of payments figures by amounts related to private suppliers' credits.

2/ Including financing gap.

3/ Assumed to be of one-year maturity.

4/ Including Libyan rescheduling, and Stanchart, 1986.

5/ Including servicing of debt to the Fund.

modestly by less than 3 percent a year, in line with the WEO assumptions. As a result of favorable price incentives and ongoing investments in the gold and timber sectors, exports of these commodities are projected to increase by about 70 percent between 1986 and 1991, while it is assumed that non-traditional exports--expected to amount to US\$25 million in 1986--would increase by roughly 30 percent a year in the remainder of the decade. As a result, the growth of total exports would average almost 10 percent both in U.S. dollar and in volume terms during the 1987-91 period. With regard to imports, the growth in volume is projected to average about 5 percent during 1987-91, following the substantial increase anticipated for 1986. Such levels of imports should be sufficient to support a real GDP growth of some 5-6 percent per year throughout the period. In U.S. dollar terms, imports would increase annually by some 9 percent on average during 1987-91.

Mostly reflecting the projected significant decline in terms of trade at the beginning of the period, Ghana's trade balance is expected to show a larger deficit in 1987, before improving steadily through 1991 when the deficit would be limited to about US\$30 million. The deficit on the services account would continue to increase during the period, in part on account of payments for technical assistance, but also in part because of rising interest payments. The latter development would reflect the assumption of continued need for limited medium-term borrowing early in the period, to supplement the disbursements under external assistance on concessional terms. Assuming that private remittances will increase by at least US\$50 million in 1987 and continue to improve thereafter, as a result of the liberalization of the exchange rate system, the external current account deficit should not rise beyond 6.4 percent of GDP in 1987 and should steadily decline to some 4.6 percent of GDP by 1991.

Concerning capital flows, the medium-term projections assume a phasing out of disbursements under the current commercial oil financing facility by 1991, and other medium-term drawings averaging some US\$165 million during 1987-91. With regard to drawings under long-term foreign assistance, they are assumed to increase by 2 percent per annum in real terms, in line with the WEO projections, from a base of US\$225 million for 1986 (taking into account the present pipeline of commitments from donor countries).

Under the above scenario which assumes the elimination of all payments arrears by the end of 1989, the financing gaps would amount to US\$140 million in 1987, US\$251 million in 1988, and US\$154 million in 1989, before declining substantially to just above US\$50 million by 1991. Staff calculations indicate that the larger part of the financing gap of the 1987-89 period could be covered by Fund resources in the context of a three-year program under the Extended Fund Facility and supplemented by the Structural Adjustment Facility (under the latter facility alone, Ghana would be eligible to request drawings of some SDR 96 million over three years). It should be noted that the level of Fund resources illustratively assumed would still imply substantial net

reflows during 1987-89. The remaining financing requirements could be covered by a partial consolidation of external payments arrears and by additional foreign assistance on concessional terms beyond the levels implied by the modest 2 percent annual real growth, assumed in accordance with the WEO exercise. A particularly strong medium-term adjustment program supported by the Fund and the World Bank could attract a larger response from the donor countries in favor of Ghana.

Debt service projections that include the servicing of the financing gap show that the debt service ratio, in percent of exports of goods and nonfactor services is likely to increase to 64 percent in 1988, but would thereafter decline significantly to about 44 percent by 1991. Servicing of the Fund debt would peak at about 31 percent of exports of goods and nonfactor services in 1988, but would be at only 12 percent two years later. These debt service obligations appear to be manageable, although 1987 and 1988 could be particularly difficult years. Gross disposable international reserves of about US\$140 million (equivalent to 9 weeks of imports) at the outset of this difficult period provides Ghana with limited flexibility as regards servicing its debt obligations in the event of an unexpected temporary shortfall of foreign exchange. Any additional foreign exchange receipts (beyond the one assumed in the medium-term scenario) that could become available in the remainder of 1986 or during 1987 ought, clearly, to be used to build up additional reserves. A successful implementation of the flexible exchange rate policy envisaged under the 1986/87 program could play a crucial role in generating these additional receipts.

The above projections appear quite cautious as regards the international prices for Ghana's main commodity exports, especially cocoa. Also, the target increase of 15,000 tons per year for cocoa productions during the next five years ought to be attainable, especially in view of the authorities' commitment to provide further incentives to that sector. In the case of Ghana, there exists, however, considerable uncertainty as regards exogenous developments, such as climatic conditions. Sensitivity analysis indicates that would cocoa exports increase by only 10,000 rather than 15,000 tons per year (bringing the projected output to 265,000 rather than 290,000 tons by 1991), the financing gaps over the 1987-89 period alone would increase by almost US\$75 million. Such a development would likely necessitate cutbacks in imports and raise concerns regarding the attainability of growth objectives, assuming no change in disbursements of foreign assistance. While the assumed levels of such assistance are substantial, they do not appear unrealistic, and could be surpassed, provided that Ghana vigorously pursues the adjustment policies envisaged for the medium term.

8. Performance criteria

The proposed stand-by arrangement is subject to quarterly performance criteria consisting of quantitative ceilings on a) net foreign assets of the Bank of Ghana; (b) net domestic assets of the

banking system, with subceilings for net claims on government and outstanding cocoa financing; c) cumulative reductions of external payments arrears through net cash payments; and d) the contracting or guaranteeing of nonconcessional external borrowing by government for maturities of 1-12 years, with a subceiling for maturities of 1-5 years. These ceilings have been established for the remainder of 1986 as shown in Table 11.

Quarterly performance criteria for 1987 will be established at the time of the review of the program with the Fund, to be completed by March 15, 1987. Completion of this review, which will cover the exchange and trade system, credit and interest rate policies, and fiscal policies, including the 1987 budget, will be treated as a performance criterion for the third purchase under the stand-by arrangement. Completion of the review will require, in particular, the unification of the flexible exchange rate system through moving remaining transactions (with the exception of SIL imports) onto the auction market not later than the first full week of January 1987.

IV. Staff Appraisal

Judging by the growth and inflation performance of the past two years, the success of Ghana's economic recovery program has been encouraging. Also noteworthy has been the ability of the Ghanaian Government to mobilize domestic resources, which has allowed progress to be made in the rehabilitation of the economic and administrative infrastructure without rekindling domestic inflation. Clearly, favorable exogenous factors since 1984, especially much improved climatic conditions, have played a role in some of these achievements. But the impact of far-reaching adjustment measures implemented by the authorities since 1983 cannot be underestimated. Hence, the 92.8 percent real depreciation of the cedi since early 1983, supported by the liberalization of domestic prices, has dramatically shifted incentives back to Ghana's most productive sectors, at the same time as it has restored a substantial part of the government's tax base. The supply response to the accompanying large increases in the producer price for cocoa has been particularly encouraging and the acceleration in production and investment in other traditional export and efficient import substitution sectors, away from pure trading activities, is also a sign of the positive effect of the adjustment in relative prices. The cautious fiscal and monetary policies pursued since 1983 have promoted not only the stabilization of the economy, as evidenced by the sharp decline in inflation to just above 10 percent in 1985, but also the redirection of domestic financial resources to the nongovernment sectors targeted under the recovery program. These resources, and their efficient allocation, have been enhanced by the pursuit of a more flexible interest rate policy. The growing financial commitments made to Ghana by bilateral and multilateral donors, although not yet fully translated into an equal acceleration of actual disbursements, reflect the growing confidence of the international community in the sustainability of Ghana's adjustment effort.

Table 11. Ghana: Quantitative Performance Criteria, 1986

	1985	1986			
	Dec. Actual	March Actual	June Prov.	Sept. Prog.	Dec. Prog.
<u>Outstanding (end of month, in millions of dollars)</u>					
Net foreign assets of Bank of Ghana (excluding bilateral accounts)	-762.6	-862.3	-948.7	-855.0 <u>1/</u>	-854.0 <u>1/</u>
<u>Outstanding (end of month, in billions of cedis) <u>2/</u></u>					
Net domestic assets					
Of which:	67.08	77.50	87.83	75.54 <u>1/</u>	85.80 <u>1/</u>
net claims on government	27.18	32.57	37.90	36.18 <u>1/</u>	30.18 <u>1/</u>
cocoa financing	13.54	14.76	11.45	-- <u>1/</u>	14.60 <u>1/</u>
<u>Cumulative changes from end-December 1985</u>					
Net domestic assets					
Of which:		10.42	20.75	8.46	18.72
net claims on government		5.39	10.72	9.00	3.00
cocoa financing		1.22	-2.09	-13.54	1.06
External payments arrears (in millions of U.S. dollars)	<u>Cumulative net cash reductions from August 1986 <u>1/</u></u>				
	<u>Outstanding</u>				
	Dec. 1985	Aug. 1986			
Other than on LCs	105.3	148.4 <u>3/</u>		10.0	10.0
On LCs	69.7	113.8		30.0	54.0
<u>During calendar year 1986</u> (in millions of U.S. dollars)					
	<u>Maximum</u>		<u>As of end-July 1986</u>		
New nonconcessional external borrowings contracted or guaranteed by government					
Of maturity 1-12 years <u>4/</u>	275.0 <u>1/</u>		147.0		
Of which: 1-5 years	250.0 <u>1/</u>		137.0		

1/ Performance criterion.

2/ Broad monetary coverage.

3/ Excluding rescheduled arrears to Libya.

4/ Including the Stanchart oil financing facility, and the Stanchart US\$80 million credit to the Bank of Ghana, but excluding any rescheduling.

The staff regrets the significant policy and monitoring slippages that have occurred in late 1985 and the first half of 1986. While part of the overrun in credit expansion on account of cocoa financing in late 1985 could be explained by the very success of the adjustment program as regards the supply response in the cocoa sector, part clearly reflects a shortfall from program targets. In this respect, the staff has urged the authorities to regularize the mechanism and timing of the transfer of the cocoa tax to the Government by linking it strictly to cocoa shipments. With regard to personal emoluments, the Fund staff had supported a substantial increase in the average civil service wage that would inevitably accompany the necessary restoration of appropriate pay relativities in the public administration. But even after the partial rollback effected in June 1986, the short run increase of the wage bill remained excessive, notwithstanding the fact that in real terms the civil servants' remunerations this year would still have been less than 50 percent of their 1972 level. The authorities' decision in August 1986 to stop the payment of most allowances for the remainder of 1986 constitutes a necessary response to the shortfall in budgetary resources that became evident in July, even though the staff would have preferred a more permanent revenue or expenditure measure.

The staff believes that the fiscal and monetary policies that the authorities have begun to implement in the second half of 1986 will temporarily recoup, if implemented fully for the remainder of the year, the slippages that have occurred in the stabilization gains since late 1985, without sacrificing the rehabilitation and growth objectives. However, the situation is tight and improved monitoring and full and timely reaction to unexpected developments will be essential. On the revenue side, the authorities' decisions to impose a temporary 10 percent import surcharge, to restore petroleum prices to the levels prevailing in early March, in spite of the continued slide in world market prices, and to effectively tax allowances, represent an effort at additional resource mobilization. In conjunction with the windfall profit on petroleum products and significant savings in other current expenditure, these revenue measures are projected to largely offset the higher wage bill. Accordingly, it will allow limiting the central government deficit (as defined earlier) to 0.2 percent of GDP, and its domestic bank financing to the envisaged target of C 3 billion (0.7 percent of GDP), without cuts in the development budget. Core capital expenditures have thus been safeguarded at the level agreed with the World Bank prior to the difficulties experienced in the first part of the year. The staff also believes that the credit targets for the remainder of 1986 will, in conjunction with the further increase in interest rates, strongly support the stabilization objectives for the year, while still providing adequate financing to the productive sectors.

The reform of the exchange rate system that will be implemented from September 1986, in the context of an auction market, is indeed a far-reaching one, as it should lead to a further significant average real depreciation of the cedi and permit the unification of the rates

under a flexible exchange rate regime at a realistic level. The rapid progress that is envisaged in the liberalization of the import licensing system will also ensure, virtually from the inception of the auction market, that foreign exchange for the importation of raw materials and equipment will go to the most efficient users. The staff has stressed to the authorities that the unification of the exchange markets at the beginning of 1987 will be essential in order to eliminate the present implicit subsidy provided by the cocoa sector to petroleum users, and that there may be only limited room in the 1987 budget to cushion through nominal wage increases the impact of higher petroleum prices on the real income of civil servants.

The sharp deterioration of the external situation in the first part of 1986 mostly reflected significant delays in earned foreign exchange receipts and in disbursements of foreign assistance. Imports which were not tied to aid inflows continued, however, to come in, a development that was fueled by an acceleration in credit expansion, with the resulting accumulation of payments arrears until June. The staff reluctantly recognized that a sizeable deficit of the overall balance of payments for the year as a whole was inevitable, particularly if the operation of the auction market from September 1986 were to start on the right footing. Nonetheless, the overall balance of payments target for 1986 does provide for a large cash reduction of arrears during the last four months of the year, by some US\$64 million. Accordingly, and notwithstanding the fact that export earnings are still expected to increase by almost 15 percent for the year, the projected overall increase in essential imports during 1986 will critically depend on the materialization of the projected substantial rise in drawings under foreign assistance, especially in the second part of the year. The current projections incorporate a conservative assessment of secured aid disbursements for 1986, as projected by the World Bank staff. There is a good chance that this target can be reached, particularly if, as anticipated, World Bank resources from RIC II and ISAC can in large part be channeled through the auction market.

The institutional and structural reforms that are necessary to create the proper environment in which both satisfactory growth and balance of payments viability could be obtained in the medium term are now generally well defined, particularly in the fields of exchange and trade policies, and of tax reform. Significant progress in these areas will have been made in 1986, and additional measures are programmed for 1987. Further recommendations to enhance budgeting and expenditure control, and to strengthen public sector management of the economic recovery program are expected to be formulated fully by the time of the review mission. In the staff's opinion, the reform of the cocoa sector, to ensure that a larger part of the world price accrues to the producer, the streamlining of the public enterprise sector, to lessen this sector's weight on the budget and claims on the economy's scarce resources, and significant progress in the redeployment of redundant labor in the public sector, will also be critical in determining whether Ghana will successfully surmount the difficult balance of payments and

debt service outlook for 1987-89. The authorities are strongly committed to providing further incentives to the cocoa sector, and intend to take a number of difficult policy decisions as regards public enterprises and redeployment policy. Close monitoring of the progress in these latter areas, as in other areas, will be necessary. The staff will continue to impress upon the authorities the need to proceed with the further liberalization and restructuring of the economy to attract increasing levels of private transfers and investments, in addition to the growing support of bilateral and multilateral donors. These elements are likely to determine the extent to which Ghana will be able to meet its heavy external obligations, including to the Fund, in the next three years without sacrificing growth.

While the consistent economic policies pursued by the authorities have begun to lay the foundation for sustained growth, program implementation and monitoring in Ghana remains weak, as evidenced by the unfortunate events of the first half of 1986, largely because of the limited resources available to the top economic management team. Improvement in the implementation and monitoring of the Government's economic policies, in addition to the continued technical and financial assistance from the donor community, will play a key role in determining the success or failure of the authorities' effort in the medium term.

The staff recommends Fund approval of the multiple currency practice which will be in effect during the temporary operation of the dual exchange rate system and the multiple currency practice that could result from the operation of the Dutch auction system. In view of the scheduled reduction and eventual elimination of external payments arrears, the staff also recommends the approval of the restrictions evidenced by such arrears, and of the restrictions arising from the foreign exchange auction.

The staff considers the amount of the proposed stand-by arrangement, at 40 percent of quota, to be appropriate in light of the relatively high Fund credit outstanding, the expectation of continued Fund involvement in support of Ghana's adjustment policies, and the already burdensome debt servicing situation. The staff believes that the proposed program offers a realistic chance to recoup the serious slippages that have recently occurred, while also continuing significant efforts to resolve structural imbalances in the Ghanaian economy. The proposed arrangement, nevertheless, would involve features departing from the usual Fund practice, especially the close bunching of purchases that would be made upon approval of the arrangement and upon meeting performance criteria for September 30, 1986. In the circumstances, and given the delays resulting from prolonged negotiations, these features appear unavoidable to the staff. Nevertheless, the staff wishes to underline that it will be particularly important that the policy implementation be fully satisfactory and performance criteria be met in order to make it possible to move successfully toward negotiation of an arrangement under the Extended Fund Facility.

V. Proposed Decisions

In view of the foregoing, the following draft decisions are proposed for adoption by the Executive Board:

(i) Stand-By Arrangement

1. Ghana has requested a stand-by arrangement in the amount equivalent to SDR 81.80 million for the period from October --, 1986 to October --, 1987.
2. The Fund approves the stand-by arrangement attached to EBS/86/224.
3. The Fund waives the limitation in Article V, Section 3(b)(iii).

(ii) Exchange System

Ghana maintains the exchange restrictions described in EBS/85/211, SM/85/252 and EBS/86/224 in accordance with Article XIV, Section 2, except that the exchange restrictions involved in the exchange auction system as well as the restrictions evidenced by external payments arrears and the restrictions on transfers of balances under the bilateral payments arrangements with Fund members are subject to approval under Article VIII, Sections 2(a) and 3. The Fund welcomes the intention of the authorities to eliminate these restrictions as soon as possible and to unify the dual exchange rates by early 1987. In the meantime, the Fund grants approval of the multiple currency practices until January 15, 1987, and for the retention by Ghana of the exchange restrictions that are subject to Article VIII until March 15, 1987 or the completion of the next Article IV consultation with Ghana, whichever is earlier. The Fund urges Ghana to terminate the remaining bilateral payments arrangements with Fund members as soon as possible.

GHANA: Stand-By Arrangement

Attached hereto is a letter dated September 23, 1986 from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana, requesting a stand-by arrangement and setting forth: (a) the objectives and policies that the authorities of Ghana intend to pursue for the period of this stand-by arrangement; and (b) understandings of Ghana with the Fund regarding the review that will be made of the progress in realizing the objectives of the program and of the policies and measures that the authorities of Ghana will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from October --, 1986 to October --, 1987, Ghana will have the right to make purchases from the Fund in an amount equivalent to SDR 81.80 million, subject to paragraphs 2, 3, 4, 5 and 6 below, without further review by the Fund.

2. a. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 16.36 million until November 15, 1986; the equivalent of SDR 32.72 million until February 15, 1986; the equivalent of SDR 49.08 million until May 15, 1987; and the equivalent of SDR 65.44 million until August 15, 1987.

b. None of the limits in a. above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Ghana's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 percent of quota.

3. Purchases under this stand-by arrangement shall be made from borrowed resources only, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Ghana will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Ghana's currency in the credit tranches beyond 25 percent of quota, or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12.5 percent of quota:

a. during any period in which the data at the end of the period indicate that:

(i) the limit on net domestic assets of the banking system described in paragraph 13 of the attached letter, or

(ii) the limit on net claims on the Government by the banking system described in paragraph 13 of the attached letter, or

(iii) the limits on outstanding cocoa financing described in paragraph 13 of the attached letter, or

(iv) the targets for the reduction of external payments arrears described in paragraph 16 of the attached letter, or

(v) the targets on quarterly net foreign assets of the Bank of Ghana described in paragraph 9 of the attached letter

are not being observed, or

b. if the limits on the contracting of new nonconcessional public and publicly guaranteed foreign indebtedness described in paragraph 17 of the attached letter are not observed; or

c. after March 15, 1987, until the review contemplated in paragraph 21 of the attached letter has been completed, and suitable performance criteria have been established, or after such performance criteria have been established, while they are not being observed; or

d. during the entire period of this stand-by arrangement if Ghana

(i) imposes new or intensifies existing restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Ghana is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Ghana and under standings have been reached regarding the circumstances in which such purchases can be resumed.

5. Ghana will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Ghana's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Ghana. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Ghana and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Ghana, the Fund agrees to provide them at the time of the purchase.

8. The value date of a purchase under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's rules and regulations. Ghana will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

9. Ghana shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

10. a. Ghana shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement, in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Ghana's balance of payments and reserve position improves.

b. Any reductions in Ghana's currency held by the Fund shall reduce the amounts subject to repurchase under a. above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

c. The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that the repurchase will be completed not later than seven years from the date of purchase.

11. During the period of the stand-by arrangement, Ghana shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Ghana or of representatives of Ghana to the Fund. Ghana shall provide the Fund, through reports at intervals or dates requested by the Fund, with such

information as the Fund requests in connection with the progress of Ghana in achieving the objectives and policies set forth in the attached letter.

12. In accordance with paragraph 21 of the attached letter, Ghana will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the stand-by arrangement and while Ghana has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Ghana's balance of payments policies.

CONFIDENTIAL

Ministry of Finance and Economic Planning
Bank of Ghana

Accra, Ghana
September 23, 1986

Dear Mr. de Larosière:

1. For the past three years the Ghanaian Government has implemented, in the context of our economic recovery program, consistent policies aimed at stabilizing the economy, restructuring relative prices in favor of productive sectors, in particular export and efficient import substitution sectors, and rehabilitating the economic and administrative infrastructure. This effort has been supported by two consecutive stand-by arrangements from the Fund for amounts totaling SDR 418.5 million, and by growing commitments and disbursements from bilateral and multilateral donors, including the World Bank. In addition, Ghana made two purchases under the Fund's compensatory financing facility for an amount totaling SDR 178.7 million during the period 1983-84.

2. The key elements of the economic recovery program have been a phased depreciation of the exchange rate which has made the exploitation of Ghana's natural resources once again profitable, the liberalization of the pricing system which has promoted domestic production in the agricultural and manufacturing sectors, and the pursuit of cautious fiscal and monetary policies which have contributed to a dramatic decline of inflation and a regained confidence in the domestic currency and banking system. These policies have supported a major effort to mobilize government revenue and private savings that has allowed a beginning to be made in addressing the rehabilitation needs of the economy, particularly the transport and communication infrastructure.

3. After a slow start, largely on account of a severe drought during 1983, our recovery program has shown clear signs of success. Real GDP grew by 10.7 percent in 1984, 5.8 percent in 1985, and is expected to continue to grow by at least 5.5 percent in 1986, owing to a projected continued good performance of the agricultural sector, including cocoa, and a significant increase in capacity utilization in the manufacturing sector. At the same time, inflation abated to less than 40 percent in 1984, and further declined to just above 10 percent in 1985.

4. Since the beginning of the recovery program, the producer price for cocoa (which accounts for more than 60 percent of our foreign exchange earnings) has been adjusted regularly, and by mid-1986 it stood at more than four times its level of 1983. Even when taking into account the more favorable climatic conditions, the supply response has been impressive, and cocoa exports have steadily increased from 154,000 metric tons in 1983/84 to 210,000 metric tons in 1985/86, which has contributed to the improvement in Ghana's balance of payments position. The recovery of other traditional exports (in particular gold

and timber) and of nontraditionals has proceeded at a more modest pace, reflecting in part longer gestation periods for the rehabilitation of plants and equipment and of the infrastructure, including port facilities. The slow improvement in these areas has also reflected the limited financial and managerial resources at our disposal to implement the ambitious reconstruction effort that is needed.

5. We are aware of the fact that in spite of the progress achieved in reducing the overvaluation of the cedi, price incentives for many traded goods, in particular nontraditional exports, have remained insufficient. Relative prices that still favor imports have also made the continued reliance on an administrative system of allocation of foreign exchange for imports necessary. This factor, in conjunction with excess capacity in the industrial, manufacturing, and trading sectors has slowed down the progress toward achieving a streamlined and efficient import substitution industry.

6. When on January 10, 1986 we effected an adjustment of the exchange rate from $\text{¢ } 60 = \text{US\$1}$ to $\text{¢ } 90 = \text{US\$1}$, we announced at the same time an increase of the minimum daily wage from $\text{¢ } 70$ to $\text{¢ } 90$, and significant changes in the structure of civil service pay relativities aimed at providing incentives for attaining greater efficiency in public administration. Adjustments have also been made to the taxation of personal incomes, with a view to ensuring that the tax system ceases to be punitive. These measures were taken in recognition of the fact that by 1985 real wages in the civil service had fallen to 29 percent of their 1972 levels, and in accordance with the recommendations of a Fund mission which visited Accra in December 1985. Particularly with regard to civil service pay relativities, however, the wage and salary increases which were actually implemented during the first five months of 1986 differed significantly from the ones agreed earlier. A number of salary related allowances were consequently increased. Data indicate that the wage and salary schedule in effect during January to May could have resulted in a growth of the total civil service wage bill (including allowances) for 1986 by 147 percent from its 1985 base, compared with the 88 percent (or 70 percent excluding allowances) that had been set during the December mission. After many weeks of efforts to correct the situation, including arduous negotiations with labor representatives, a revised permanent wage and salary scale was put in place in June, which on an annual basis would limit the wage bill growth for 1986 to 125 percent from its 1985 base, implying a total wage bill of $\text{¢ } 30.8$ billion. However, to ensure that the overall budgetary targets for 1986 are attained, payment of all allowances to civil servants is being limited to the amount already paid. Allowances for the rest of the year have been cancelled. This will lead to a reduction in the programmed government wage bill by $\text{¢ } 4.5$ billion to $\text{¢ } 26.3$ billion, representing a 92 percent increase over its 1985 base.

7. The substantial pay increases granted in the civil service led to pay increases in the state enterprises and in the private sector, whose wage bill is projected to increase on average by about 60 percent over

its 1985 level. In conjunction with the sizeable reduction in the effective rate of personal income taxation, the incomes policy during 1986 is thus expected to exert some inflationary pressures, both on the demand and supply sides. This situation may have been compounded by the liquidity expansion in late 1985 and early 1986, mostly in conjunction with credit to the cocoa sector at the end of 1985 and to the Government in early 1986. Although the fiscal and credit policies that we intend to pursue in the remainder of 1986 are expected to bring price inflation under better control, we recognize that the average inflation of the CPI during 1986 could be in the range of 20 to 25 percent, an assessment which is supported by the data for the first five months of 1986.

8. During the Annual Meetings in Seoul in September 1985, and on several occasions thereafter, we have indicated that the Ghanaian authorities intend to continue to seek Fund support for their recovery program, and that in view of the structural and institutional nature of the policy reforms that will be necessary to resolve the problems alluded to above, the appropriate time horizon appeared to coincide with the one of a three-year Extended Fund Facility. This view was and, we believe, continues to be shared by the Fund staff. However, the detailed preparation of medium-term structural adjustment measures that we intend to implement to ensure both sustained growth and long-term balance of payments viability requires that we consolidate the gains of the stabilization policies, and also that the economic and policy developments of recent months do not undermine these gains. In the coming months, therefore, the stabilization policies will remain particularly crucial. Accordingly, after discussion with the Fund staff, we have concluded that Fund assistance for these policies may at present best be sought in the context of a one year stand-by arrangement beginning in October 1986. The stand-by arrangement that we are therefore requesting is for an amount equivalent to SDR 81.80 million (40 percent of quota). We wish to reiterate, however, that our objective remains to put in place a medium-term program to be supported by an Extended Fund Facility as soon as possible in early 1987. It is thus our understanding that the requested stand-by arrangement could be replaced at the appropriate time by an extended arrangement.

9. The adjustment of the exchange rate from $\text{¢ } 60 = \text{US\$1}$ to $\text{¢ } 90 = \text{US\$1}$ in January 1986 reflected our decision to make a significant step towards our objective of reaching an equilibrium exchange rate. To ensure a smooth transition to that objective, as well as to obtain a more direct indication of how far the exchange rate will have to depreciate before it reaches its equilibrium, we have decided to institute an auction system for determination of the exchange rate. The first auction will take place on September 19. While all foreign exchange proceeds will continue to be surrendered to the Bank of Ghana, the Bank will supply foreign exchange to the public through a weekly auction, where the value of the cedi against the U.S. dollar will be freely determined as the marginal rate (i.e., the rate where demand exhausts supply) and where all bidders who bid above this market clearing rate will be allocated the full amount of their bid for foreign

exchange at the rate they bid. The marginal rate struck in the preceding auction will be the exchange rate at which the Bank of Ghana purchases foreign exchange from the public. All importers with a valid import license other than Special Import Licenses will be allowed access to the auction to settle maturing foreign exchange transactions in respect of imports, and importers may also bid for foreign exchange with which to open letters of credit before a foreign exchange payment is due. In the latter case, the only documentation required to establish eligibility will be a valid import license and a pro forma invoice. Foreign exchange secured from the auction to open letters of credit will be blocked in an account with the commercial banks until the letter of credit matures. As far as service payments are concerned, bids for foreign exchange to settle a transaction approved by the Bank of Ghana will also have free access to the auction. A timetable for when holders of Special Import Licenses will be allowed to bid in the foreign exchange auction will be established at the time of the review of the 1986/87 program. For a temporary period, foreign exchange to service official debt that was outstanding by the end of December 1985, for oil imports, and for imports of essential drugs not exceeding US\$7.5 million will be provided at the official exchange rate fixed at C 90. Export earnings from cocoa and residual oil will also be converted at the official rate. The exchange rate system will be unified not later than the first full week of January 1987 and the official market transactions will from then on be channelled through the auction market. The regulations governing the operation of the foreign exchange auction market have been agreed with the Fund staff and we will consult with the staff before making any modification to these regulations. We will refrain from administrative interference in the auction system. We are currently also planning a wide-reaching liberalization of the trade system in cooperation with the World Bank. From October 1, 1986, licences will be issued freely to everyone wanting to import most nonconsumer goods. Holders of these licenses will be given free access to bid in the foreign exchange auction for foreign exchange to settle maturing payments relating to imports and for foreign exchange to open letters of credit. The Bank of Ghana's auction supply policy will be determined with a view to protecting its net foreign assets position. Net foreign assets of the Bank of Ghana, which stood at minus US\$763 million by the end of December 1985 and minus US\$891 million by the end of August 1986, will, as a performance criterion, not be less than minus US\$855 million, by the end of September 1986 and minus US\$854 million by the end of December 1986. For the purpose of this paragraph, net foreign assets of the Bank of Ghana are defined to include its holdings of gold, SDRs, foreign notes and coins, foreign securities, the disposable working balances with foreign correspondent banks, liabilities to the IMF, external arrears, and all liabilities of the Bank of Ghana with an original maturity of less than one year. Also, the planned borrowing by the Bank of Ghana from Stanchart of US\$80 million will be included in the net foreign assets target, as well as other similar borrowing by the Bank of Ghana for balance of payments purposes.

10. The overall deficit of the central government has been constrained by limiting foreign concessional assistance earmarked to the budget to a level that has already been firmly secured, and by a limit on the financing of the deficit by the domestic banking system of ₵ 3.0 billion. This results in a deficit of ₵ 0.9 billion in 1986, equivalent to 0.2 percent of GDP, compared with a deficit of ₵ 7.6 billion, equivalent to 2.3 percent of GDP, in 1985. These figures do not include project-aid financed expenditures and their financing, which currently amount to about 3.5 percent of GDP; it is our intention to incorporate these expenditures in the 1987 budget presentation. Should foreign assistance additional to the US\$75 million retained for 1986 become available, we will determine the use of these resources at the time of the program review. The budget calls for total revenue of ₵ 84.9 billion, 111 percent higher than in 1985, and provides for expenditure of ₵ 85.8 billion, 79 percent higher than in 1985.

11. A number of factors are expected to contribute to the increase in revenue. Major efforts have been made to improve tax collection procedures, particularly with regard to the company income tax. The increase in wages and salaries throughout the economy will boost personal income tax payments, despite a reduction in marginal tax rates and an increase in personal exemptions. Since August 1, a number of allowances to non-civil service employees which were previously paid free of tax, have been subject to tax. Import taxes have also benefited from the exchange rate adjustment at the beginning of the year. The latter, in conjunction with higher cocoa prices and an increase in crop size will result in the Cocoa Board increasing substantially its contribution to the budget. The windfall profit resulting from the difference between the domestic price of petroleum products and their landed cost is the principal new source of revenue. Taking into account the increase of retail petroleum prices, announced on June 29, back to the level of end-January, the total windfall profit would amount to about ₵ 5 billion for the whole of 1986 based on conservative assumptions on the cost of oil imports and domestic refining cost. The Government has decided to consolidate this profit into a specific excise duty on petroleum by October 15, 1986. The size of the excise duty will be determined after provision of about ₵ 2 billion for the capitalization needs of the Ghana National Petroleum Corporation in 1987. This will protect the sizeable fiscal revenue involved in the event of an increase in the world oil price. A temporary import surcharge on all non-oil imports has also been introduced for the second half of the year and is expected to yield ₵ 3.1 billion. As detailed above, higher levels of civil service pay will contribute significantly to the increase in expenditure in 1986. External debt interest is markedly higher than in 1985 as a result of the exchange rate adjustment and carry-over into 1986 of obligations due at the very end of 1985. With regard to capital expenditure, the government is pushing ahead with the program agreed with the World Bank. However, to the extent that there remains some uncertainty as to the ability of the Cocoa Board to transfer the projected ₵ 17 billion of export tax to the Government during 1986, while at the same time reducing the outstanding cocoa

financing from the banking system to zero by the end of the present crop year (end-September), the Government has identified contingent expenditure cuts that could be enacted at short notice in the last quarter of 1986 in the event of a shortfall in export tax receipts. However, these may not be necessary since the company income tax, the windfall profit on petroleum, and the import taxes could potentially generate significantly more revenue than allowed for in the budget. It is understood that no new domestic arrears will be incurred.

12. Monetary and credit policies for the remainder of 1986 have been formulated with the objective to promote economic activity in the productive sectors, while at the same time remaining consistent with the attainment of the inflation and balance of payments targets. In view of the higher projected inflation for 1986, as compared with 1985, it has not been possible to program an increase of the broad money/GDP ratio for this year. Accordingly, the expansion of net domestic assets over 1986 will be limited to ₵ 18.7 billion, or about 28 percent, of which only ₵ 3 billion will contribute to financing the government deficit. Reflecting the large outstanding debt of the Cocoa Board at the end of last year, cocoa financing is programmed to increase by only ₵ 1.1 billion from end-December 1985 to end-December 1986, to reach ₵ 14.6 billion, equivalent to the financing of about 65 percent of the projected 1986/87 crop of 225,000 tons, including provision for operating cash needs of ₵ 2.2 billion in the fourth quarter of 1986. The latter figure provides for ₵ 0.5 billion of retrenchment costs in the last quarter of 1986, as part of a phased program during the 1986/87 crop year. The expansion of credit to the rest of the economy is programmed at ₵ 17.0 billion during 1986, with the implied difference of ₵ 2.4 billion between total net domestic credit and domestic assets expansion being accounted for by projected drawings (US\$21.5 million) under long-term credit facilities from the African Development Bank and the EEC to two development banks in Ghana.

13. As regards overall credit developments, performance criteria for end-September and end-December 1986 have been set with due consideration to the seasonality of broad money behavior and of indicative changes in net foreign assets targets; the latter in turn have been formulated on the basis of quarterly cashflow projections. Accordingly, overall net domestic assets will not exceed ₵ 75.54 billion at end-September and ₵ 85.80 billion at end-December 1986. Subceilings on net claims on government have been set taking into account the need to progressively reduce, during the remainder of the year, the Government's net indebtedness vis-à-vis the banking system which had increased by more than ₵ 5 billion in the first quarter of 1986 and is estimated to have risen by another ₵ 5 billion in the second quarter. Accordingly, net claims on government will not exceed ₵ 36.18 billion at end-September and ₵ 30.18 billion at end-December 1986. Finally, outstanding cocoa financing of zero by end-September and not exceeding ₵ 14.60 by end-December 1986 will also constitute performance criteria under the program.

14. Under the past two stand-by arrangements, the Bank of Ghana pursued a more flexible interest rate policy which, in conjunction with the rapid decline in the rate of inflation during 1985, had yielded significantly positive real rates of interest on deposits. The upward revision of the projected rate of inflation to between 20 and 25 percent for 1986 made it necessary to increase in August 1986, across-the-board, the deposit rates by 2 percentage points, bringing the 12-month deposit rate to 20 percent. At the same time, to encourage mobilization of longer term resources, the interest rates on 24-month deposits have been increased by 3 percentage points to 22 percent. These adjustments are in line with the authorities' objective to maintain positive real interest rates over the program period. As regards the lending rates, we eliminated the preferential interest rates previously granted to agricultural and export sectors and broadly unified the rates upwards toward the maximum of 23 percent, with the objective to encourage the supply of credit to these sectors. In order to better equalize the cost of financial resources for the banks between the different types of deposits, we are reducing cash reserve requirements on time and savings deposits. Our aim is to promote the mobilization by the banks of domestic term resources that could in turn support medium- and long-term loans.

15. Export earnings are projected to increase by US\$91 million in 1986, reflecting almost entirely an improvement in earnings from export of cocoa. However, this is expected to be more than offset by an increase in imports, and the trade deficit will widen from US\$36 million in 1985 to US\$63 million in 1986. The increase in imports reflects mainly a projected increase in disbursements of project loans and grants from official multilateral and bilateral sources of almost US\$100 million. This projection is fairly conservative and the Government is hoping that the disbursement in the second half of 1986 can be speeded up, in which case imports might be higher. Accordingly, the external current account deficit is expected to rise to 5.1 percent of GDP in 1986, from 2.6 percent of GDP in 1985. As far as the overall balance of payments is concerned, we intend to recoup part of the deterioration of the first part of the year and to limit its overall deficit to US\$81 million, compared to a deficit of almost US\$100 million in 1985.

16. Total external arrears, excluding US\$70 million relating to requests for foreign exchange to settle drawings under letters of credit, amounted to US\$105 million at end-December 1985 and US\$148 million at end-August 1986. Such arrears will not exceed US\$138 million by the end of September 1986, and also by the end of December 1986. Liabilities relating to drawings under letters of credit, which increased by US\$44 million between end-December 1985 and end-August 1986 to US\$114 million, will not exceed US\$84 million by the end of September 1986 and US\$60 million by the end of December 1986. No new arrears will be incurred. We will establish with the Fund at the time of the review a scheme for total elimination in 1987 of the remaining arrears relating to letters of credit and a timetable for the elimination of all other arrears over a three year period.

17. The debt service obligations on our external debt, including those under the oil financing facility and those to the Fund, have increased significantly during the past three years and will reach 52 percent of our exports of goods and nonfactor services in 1986. To prevent further pressure on our own balance of payments resources in that period, and in view of the large repurchases from the Fund falling due over the next three years, we intend to pursue a prudent debt management policy during 1986. Accordingly, we intend to limit for the calendar year 1986 the contracting of government and government-guaranteed external loans on nonconcessional terms in the maturity range of 1-12 years to US\$275 million, and as a subceiling, to limit those in the maturity range of 1-5 years to US\$250 million. These ceilings exclude any rescheduling of external debt. New drawings during 1986 under the Stanchart oil financing facility, which are projected to decline to some US\$57, have been included in the above subceiling. Also included is a US\$80 million loan from Stanchart, of 2 years' maturity with half a year's grace.

18. The Government has already made progress on a program of structural and institutional reforms, with particular emphasis on tax policy and administration, state enterprises, public sector management, and the cocoa sector. As mentioned above, the personal income tax has been reformed and the tax administration is being rehabilitated. This represents a decisive response to recommendations made by the recent Fund technical assistance mission. Efforts to promote an effective and efficient tax administration will continue. Other Fund recommendations will also be acted upon. The company income tax will be reformed to provide appropriate incentives to the productive sector of the economy. This will be supported by a unification of the sales tax regime, which currently distorts production. The effective direct tax on cocoa exports will also be reduced, and the Government's intention is that the cocoa export duty will be eventually replaced by an agricultural income tax and that preparations towards achieving this objective will be made during the 1987-89 medium-term program.

19. State enterprises impose a heavy financial burden on the budget, and the Government is committed to having in place a commercially oriented and financially self-sufficient state enterprise sector. To this end the Government has embarked upon a program of state enterprise reform involving changes in regulatory regimes, recapitalization, price restructuring, competition policy, labor rationalization, and changes in management and ownership structure. The reform process will inevitably be lengthy, and progress to date has been limited to the formulation of a policy statement on state enterprises. However, enterprises to operate under particular pricing and market regimes have already been identified. In addition, a timetable has been drawn up and before the end of 1986 a redeployment program will begin to be implemented, all enterprises will prepare full financial accounts and corporate plans (and preparations will be made to eliminate all cross arrears), and management and manpower training programs will be introduced. With the provision of up-to-date financial accounts for the public enterprises,

it is our intention to assess their financing needs in 1987, both from the banking system and the central government, and to monitor their financial performance and use of credit during the year. In conjunction with the World Bank, a timetable for the strengthening of public sector management has been agreed. The Government has embarked upon a program of redeployment of public sector workers, for which provision of C 1 billion has been made in the 1986 program budget. The Government has made significant progress in rehabilitating the cocoa sector in recent years. Returns to cocoa farmers have been increased, Cocoa Board operations have been streamlined and services management has been strengthened. We will continue to build upon this start by further improving producer incentives (partly by the reform of cocoa taxation referred to above and partly by establishing a producer price which represents an appropriate proportion of the world price by 1988/89) and by reducing the operating costs of the Cocoa Board and eliminating low priority activities from its budget.

20. During the period of the stand-by arrangement, the Government does not intend to impose any new, or intensify any existing, restrictions on payments and transfers for current international transactions, to conclude any bilateral payments agreements with Fund members, or to introduce any new, or intensify any existing, restrictions on imports for balance of payments reasons.

21. The Government believes that the policies set forth in this letter are adequate to achieve the economic and financial objectives of the program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund on such consultation. Progress made in the implementation of the program, including the operation of the dual exchange rate system detailed above, other trade, monetary, interest rate, and fiscal policies, as well as the 1987 budget will be subject to a review with the Fund, expected to be initiated in October/November 1986 and to be completed by March 15, 1987. The making of the third purchase under the stand-by arrangement will be contingent upon completion of this review.

Sincerely yours,

Dr. Kwesi Botchwey
PNDC Secretary for Finance
and Economic Planning

J.S. Addo
Governor
Bank of Ghana

GHANA--Relations with the Fund
(As of September 1, 1986)

I. Membership Status

- | | |
|------------------------|--------------------|
| (a) Date of membership | September 20, 1957 |
| (b) Status | Article XIV |

A. Financial Relations

II. General Department

- | | |
|-------------------------------------|---|
| (a) Quota | SDR 204.5 million |
| (b) Fund holdings of local currency | SDR 801.7 million, or
392.0 percent of quota |

	<u>Millions of SDRs</u>	<u>Percent of quota</u>
(c) Use of Fund credit	597.2	292.0
Credit tranches	204.5	100.0
Enlarged access	214.0	104.6
CFF	178.7	87.4
(d) Repurchase obligations (October 1986- September 1987)	108.4	53.0

III. Stand-By Arrangements and Special Facilities

- (a) On August 27, 1984 the Executive Board approved a 16-month stand-by arrangement for SDR 180 million (88 percent of quota). The arrangement provided for six equal purchases. Ghana made all purchases upon meeting the relevant performance criteria and successfully completing two reviews. The last purchase was made in mid-December 1985.
- (b) On August 3, 1983 the Executive Board approved a one-year stand-by arrangement for SDR 238.5 million (150 percent of Ghana's quota then in force). The arrangement provided for five equal purchases. Ghana made all purchases upon meeting the relevant performance criteria and successfully completing two reviews. The last purchase was made in mid-May 1984.
- (c) There was only one other one-year stand-by arrangement in the past ten years. It was approved by the Executive Board on January 10, 1979 for SDR 53 million (50 percent of Ghana's quota at that time). Ghana made one purchase of SDR 32 million. A subsequent purchase was subject to successful completion of a review. A change of government took place in early June 1979 while a staff review mission was in Accra. The review could not be completed and the arrangement lapsed on January 9, 1980.

GHANA--Relations with the Fund (continued)
(As of September 1, 1986)

(d) On December 4, 1984 the Board also approved Ghana's request for a CFF purchase of SDR 58.2 million (28 percent of quota) on account of both a shortfall in merchandise exports and an excess in the cost of cereal imports for the 12-month period ending May 1984.

(e) On August 3, 1983 the Board approved Ghana's request for a CFF purchase of SDR 120.5 million (75.8 percent of the quota then in force) on account of a shortfall in exports during the calendar year 1982.

IV. SDR Department (as of August 31, 1986)

(a) Net cumulative allocation	SDR 62.98 million
(b) Holdings	SDR 2.03 million, or 3.2 percent of net cumulative allocation

V. Administered Accounts (as of August 31, 1986)

Trust Fund loans	
(i) Disbursed	SDR 48.96 million
(ii) Outstanding	SDR 32.68 million

VI. Overdue Obligations to the Fund None

B. Nonfinancial Relations

VII. Exchange System

Ghana maintains a flexible exchange rate system, using the U.S. dollar as the intervention currency. In April 1983 Ghana depreciated the cedi through the introduction of a multiple exchange rate system. In October 1983 the exchange rate system was unified at the rate of ¢ 30 = US\$1 compared with the exchange rate of ¢ 2.75 = US\$1 that prevailed prior to April 1983. In March 1984, the cedi was depreciated to ¢ 35 = US\$1; on August 23, 1984 to ¢ 38.5 = US\$1; on December 3, 1984 to ¢ 50 = US\$1, on April 19, 1985 to ¢ 53 = US\$1, on August 12, 1985 to ¢ 57 = US\$1, on October 7, 1985 to ¢ 60 = US\$1, and on January 10, 1986 to ¢ 90 = US\$1. Ghana maintains restrictions on payments and transfers for current international transactions primarily in the form of external payments arrears.

GHANA--Relations with the Fund (continued)
(As of September 1, 1986)

VIII. Last Article IV Consultation and Stand-By Arrangement

June 24-July 10, 1985; Executive Board discussion,
September 13, 1985. Decisions as follows:

(i) 1985 Consultation

1. The Fund takes this decision relating to Ghana's exchange measures subject to Article VIII, Section 2, in concluding the 1985 Article XIV consultation with Ghana and in light of the 1985 Article IV consultation with Ghana conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The restrictions on payments and transfers for current international transactions, as described in EBS/85/211 and in SM/85/252, are maintained by Ghana in accordance with Article XIV except that the exchange restrictions evidenced by external payments arrears and the restrictions on transfers of balances under the bilateral payments arrangements with Fund members are subject to approval under Article VIII, Section 2. The Fund notes the intention of the authorities to remove these exchange restrictions as soon as possible and grants approval for the retention of the exchange restrictions that are evidenced by external payments arrears, until August 31, 1986 or the completion of the 1986 Article IV consultation with Ghana, whichever is the earlier. The Fund urges Ghana to terminate the remaining bilateral payments arrangements with Fund members as soon as possible.

Ghana was placed on a 12-month Article IV consultation cycle.

(ii) Stand-By Arrangement

May 19-June 13, 1984; Executive Board discussion,
August 27, 1984 (EBM/84/128). Decisions as follows:

1. Ghana has requested a stand-by arrangement in the amount equivalent to SDR 180.0 million for the period from August 27, 1984 to December 31, 1985.

2. The Fund waives the limitation in Article V, Section 3(b)(iii).

3. The Fund approves the stand-by arrangement attached to EBS/84/172.

GHANA--Relations with the Fund (continued)
(As of September 1, 1986)

A modification of performance criteria under the 1984/85 stand-by arrangement was approved by the Executive Board on December 3, 1984; the decision read as follows:

1. Ghana has consulted with the Fund in accordance with paragraphs 10 and 11 of the stand-by arrangement for Ghana (EBS/84/172, as amended) and paragraph 31 of the letter dated July 30, 1984 from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana.

2. The communication from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana, and the letter from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana dated July 30, 1984 shall read as supplemented and modified by the communication dated November 28, 1984.

3. Accordingly, the limits on total net domestic assets of the banking system for end-December 1984, shall be those referred to in the communication dated November 28, 1984 in place of those referred to in paragraph 23 of the letter of July 30, 1984 and specified in the table appended to it, and there will be a separate limit for maize financing, as specified in the communication dated November 28, 1984.

The first review under the 1984/85 stand-by arrangement was completed by the Executive Board on May 22, 1985; the decisions read as follows:

1. Ghana has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Ghana (EBS/84/172, Supplement 4, August 29, 1984) and paragraph 31 of the letter of intent signed by the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana dated July 30, 1984, attached to the stand-by arrangement, as supplemented and modified by their communication of November 28, 1984, in order to establish performance criteria subject to which purchases may be made by Ghana under the stand-by arrangement.

2. The letter dated April 26, 1985 from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana shall be annexed to the stand-by arrangement for Ghana, and the letter dated July 30, 1984 shall be read as supplement and modified by the communication of November 28, 1984 and by the letter of April 26, 1985.

GHANA--Relations with the Fund (continued)
(As of September 1, 1986)

3. Accordingly, the limits on net domestic assets of the banking system and net claims on the Government by the banking system for end-March, end-June, end-September, and end-December 1985, shall be as specified in paragraph 11 of the letter dated April 26, 1985.

4. The stand-by arrangement for Ghana is amended to read as stated in Appendix I to EBS/85/110 (May 1, 1985), in accordance with the Decision No. 7908-(85/26), adopted February 20, 1985.

The second review under the 1984/85 stand-by arrangement was completed by the Executive Board on September 13, 1985; the decisions read as follows:

1. Ghana has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Ghana (EBS/84/172, Supplement 4, August 29, 1984) and paragraph 31 of the letter of intent signed by the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana dated July 30, 1984, attached to the stand-by arrangement, as supplemented and modified by their communication of November 28, 1984, and the letter of April 26, 1985.

2. The letter dated August 27, 1985 from the Secretary of Finance and Economic Planning and the Governor of the Bank of Ghana shall be annexed to the stand-by arrangement for Ghana, and the letter dated July 30, 1984 shall be read as supplemented and modified by the communication of November 28, 1984, the letter of April 26, 1985, and the letter of August 27, 1985.

3. The Fund finds that no further understandings are necessary, and that Ghana may proceed to make purchases under the stand-by arrangement.

IX. Technical Assistance

Panel Expert

Bank of Ghana (banking operations
and accounts): 1981-82

Bureau of Computing Services

Bank of Ghana (systems analysis):
June 1985

GHANA--Relations with the Fund (concluded)
(As of September 1, 1986)

Bureau of Statistics	Bank of Ghana (Institutional coverage and classification of financial institutions' accounts relating to the derivation of monetary aggregates): December 1984 and June 1985
Exchange and Trade Relations Department	Ministry of Finance and Economic Planning, Bank of Ghana (exchange rate study): August 1985 (auction market): August and September 1986
Fiscal Affairs Department	Ministry of Finance and Economic Planning (reform of the tax system): September 1985 (expenditure control): July 1986
<u>X. Resident Representative</u>	A Fund resident representative has been posted in Accra since June 1985.

Relations with the World Bank Group
(as of June 30, 1986)

(In US\$ millions)

Lending Operations <u>1/</u>	IBRD and IDA			
	Credit number	Total Commit- ments <u>2/</u>	Dis- bursed <u>3/</u>	Undis- bursed <u>4/</u>
Loans and credits fully disbursed		297.13	297.13	
Second NIB	901	19.00	18.64	0.36
Agricultural development (Volta region)	1009	29.50	9.88	19.62
Third highway	1029	25.00	24.44	0.56
Railways	1170	29.00	19.01	6.43
CIMAO	1327	9.30	0.00	10.13
Water supply	1342	13.00	8.25	4.58
Energy (petroleum exploration)	1373	11.00	3.21	8.36
Reconstruction imports credit (RIC)	1393	40.00	33.11	5.92
Export rehabilitation - IDA	1435	40.10	18.42	24.71
Export rehabilitation - SF	009	35.90	14.19	24.77
Export rehabilitation - T.A.	1436	17.10	7.69	10.42
Petroleum Refinery	1446	6.90	1.67	5.84
Oil palm II	1498	25.00	3.95	23.27
Accra district rehabilitation	1564	22.00	3.75	22.48
Second RIC - IDA	1573	60.00	31.41	38.77
Second RIC - AF	003	27.00	0.00	30.73
Road rehabilitation - IDA	1601	40.00	3.65	43.67
Road rehabilitation - AF	001	10.00	0.00	11.89
Power system rehabilitation	1628	28.00	1.61	30.14
Health and education	1653	15.00	2.17	14.07
Industrial sector - IDA	1672	28.50	3.73	26.52
Industrial sector - AF	013	25.00	5.62	20.83
Ports <u>5/</u>	1674	24.50	0.00	24.50
Total		<u>877.93</u>	<u>511.53</u>	<u>408.57</u>
Less amount repaid		76.71		
Total outstanding (incl. undisbursed) <u>6/</u>		801.22		

Source: World Bank.

1/ Less cancellations.

2/ U.S. dollar equivalent at time of Board approval (credits denominated in SDRs).

3/ Converted into U.S. dollars at exchange rate applicable on transaction date.

4/ Converted into U.S. dollars at exchange rate applicable on June 30, 1986.

5/ Not yet effective as at June 30, 1986.

6/ Due to exchange rate adjustment, disbursed and undisbursed amounts do not add up to total commitments.

GHANA - Basic Data

Area, population, and GDP per capita

Area	238,537 square kilometers
Population: Total (1984)	12.7 million
Growth rate	3.0 percent
GDP per capita (1985)	SDR 460

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u> Prov.	<u>1986</u> Proj.
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Gross domestic product

Total (in millions of cedis)	86,451	184,038	272,297	332,717	438,770
At 1975 prices	4,974	4,733	5,240	5,546	5,851

(In percent of GDP)

Agriculture	54	54	55	53	...
Manufacturing	7	7	7	8	...
Government	13	14	13	12	...

(Annual percentage change)

Nominal GDP	19.0	113.0	47.9	22.2	31.9
Real GDP	-6.9	-5.0	10.7	5.8	5.5
Exports (volume)	11.0	-26.7	-3.9	21.9	7.0
Imports (volume)	-35.7	-0.2	13.3	6.4	27.7

Prices

GDP deflator	27.9	123.7	33.6	15.5	25.0
Consumer price index	23.3	121.9	40.2	10.4	25.0
Export prices	-23.1	-1.2	33.9	-8.3	4.9
Import prices	-4.0	-3.0	-3.0	0.3	-21.3
Terms of trade	-19.9	1.9	38.0	-8.6	33.4

(In millions of cedis)

<u>Central government finance</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u> Prov.	<u>1986</u> Proj.
Revenue and grants	5,253	10,241	22,641	40,312	84,924
Expenditure and net lending	9,220	15,178	27,485	47,982	85,797
Of which: current expenditure	(8,029)	(13,404)	(23,326)	(38,462)	(64,044)
Overall deficit	-3,967	-4,937	-4,844	-7,579	-873
Overall deficit as percent of GDP	-4.6	-2.7	-1.8	-2.3	-0.2
Foreign financing (net)	215	687	1,820	3,522	-3,627
Domestic financing (net)	3,752	4,250	3,024	4,058	4,500
Of which: banking system <u>1/</u>	(434)	(2,572)	(1,264)	(3,373)	(3,000)

GHANA - Basic Data concluded

	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u> Prov.	<u>1986</u> Proj.
Money and credit (end of period)	<u>(Annual percentage change)</u>				
Net domestic assets	20.1	41.2	32.0	68.2 <u>1/</u>	27.9
Net claims on Government	3.8	23.5	8.4	12.5 <u>1/</u>	11.0
Credit to rest of economy	17.7	73.8	99.5	89.4 <u>1/</u>	65.5
Broad money	23.4	38.1	39.3	59.5 <u>1/</u>	19.0
Velocity (ratio)	6.9	9.0	9.5	5.9 <u>1/</u>	6.6
<u>Balance of payments</u>	<u>(In millions of U.S. dollars)</u>				
Exports, f.o.b.	607.0	439.7	565.9	632.4	723.6
Of which: cocoa	(406.5)	(275.7)	(381.6)	(412.0)	(501.0)
noncocoa	(200.5)	(164.0)	(184.2)	(220.4)	(222.6)
Imports, f.o.b.	588.7	569.9	626.5	668.7	786.4
Of which: oil	(306.9)	(161.1)	(161.0)	(199.0)	(121.7)
Trade balance	18.3	-130.2	-60.6	-36.3	-62.8
Services and transfers (net)	-127.0	-151.1	-38.0	-146.1	-161.2
Current account	-108.7	-281.7	-98.6	-182.4	-224.0
Capital account (net)	137.7	154.6	-8.6	62.4	143.0
Of which:					
official capital (net)	(112.8)	(67.4)	(87.8)	(32.1)	(117.6)
monetary and other					
short-term capital	(13.6)	(60.9)	(-84.7)	(24.5)	(--)
SDR allocation	--	--	--	--	--
Errors and omissions	-1.7	-115.9	-13.8	21.9	--
Overall balance	27.3	-243.0	-121.0	-98.1	-81.0
Current account balance					
as percent of GDP	-0.3	-2.9	-1.3	-3.0	-5.1
<u>Gross official foreign reserves</u>					
End of period <u>2/</u>	223.9	184.6	199.4	126.2	137.0
In weeks of imports	19.8	16.2	16.5	9.8	9.1
<u>External public debt</u>					
Disbursed and outstanding (end					
of period; including Fund)	1,211.7	1,639.3	2,049.3	2,203.1	2,351.6
Debt service as percent of					
exports of goods and non-					
factor services					
Excluding the Fund	12.2	26.8	25.9	43.8	42.5
Including the Fund	13.4	30.9	29.4	51.6	52.5
<u>Exchange rates</u>					
End of period	2.75	30.0	50.0	60.0	...
Period average	2.75	18.7	35.9	54.4	...

1/ Broad coverage, beginning 1985.

2/ From 1984, gross reserves are on a disposable basis.