INSTITUTE FOR FISCAL STUDIES

POLICY BRIEF No.14

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THE INSTITUTE FOR FISCAL STUDIES' ASSESSMENT OF THE 2022 BUDGET

1. INTRODUCTION

Ghana has been facing a very difficult fiscal situation for quite some time. Since 2012, the country has run large fiscal deficits, which have led to rapid debt build-up. The ratio of public debt to GDP, which stood at 29.1% in 2011, climbed swiftly to 55.6% in 2016. This led to a sharp increase in interest expenditure from 13.2% of total revenue and grants in 2011 to 35.8% in 2016.

In 2017–2019, the officially declared budget deficit fell to an average of 4.4% of GDP from an average of 6.5% of GDP in 2013–2016. However, in addition to the borrowings used to finance the declared deficits in this period, the government embarked on massive extra-budgetary borrowings mainly to fund the public intervention in the financial sector and contingent liabilities in the energy sector. Therefore, if these borrowings and spending were accounted for within the national budget, the fiscal deficit ratios would be far more than the officially declared ones in this period. For instance, using data published by the IMF, which include the financial and energy sector costs, Ghana's fiscal deficit averaged 6.4% in 2017-2019. This, therefore, kept the public debt on an upward trajectory, reaching 61.2% of GDP in 2019. Interest expenditure also jumped to 37% of revenue in 2019, and by this time, Ghana was already facing one of the largest debt interest payment burdens in the world. In 2020, the impact of the Covid-19 pandemic and election-motivated public spending widened the official fiscal deficit to as high as 11.7% of GDP. Indeed, including the financial and energy sector related costs, the 2020 fiscal deficit stood at a whopping 15.2% of GDP, which is unprecedented in Ghana's post-independence history. This drove up the public debt dramatically to 76% of GDP. Consequently, interest expenditure further ballooned to 44.6% of total revenue. This grave fiscal situation at the end of 2020 required the government to embark on urgent and credible fiscal consolidation from 2021 onwards.

2. ANALYSIS OF THE 2021 BUDGET'S IMPLEMENTATION

Before we discuss the 2022 budget presented to Parliament on November 17, 2021 by the Minister for Finance, it is important to examine the implementation of the 2021 budget, as this will provide a useful context to assess the 2022 budget.

The 2021 fiscal data reported in the 2022 budget show that the execution of the 2021 budget, which aimed to consolidate the public finances by reducing the official fiscal deficit from 11.7% of GDP in 2020 to 9.4% of GDP in 2021, has been plagued by shortfalls in revenue mobilization. In the first three quarters of 2021, these shortfalls cumulatively amounted to GH¢4.08 billion, as total revenue and grants collected was GH¢47.23 billion against a target of GH¢51.31 billion. In response, the government restrained expenditure (including arrears payment and discrepancy) by GH¢2.80 billion, with actual expenditure standing at GH¢81.09 billion against a target of GH¢83.89 billion. Thus, the cut in expenditure was lower than the shortfall in revenue. Therefore, the resulting fiscal deficit was GH¢33.86 billion (7.7% of GDP) against a target of GH¢32.58 billion (7.4% of GDP) for the first three quarters.

For the whole of 2021, the government has now reprogrammed total revenue and grants to be GH¢70.35 billion, indicating an anticipated shortfall of GH¢2.13 billion, compared with the revised budget target of GH¢72.48 billion as reported in the 2021 Mid-year Review Budget. In our view, this projected outturn of total revenue and grants appears not credible and is unlikely to be achieved. This is because the projection implies that the government will collect total revenue and grants of GH¢23.11 billion in the last quarter of 2021, thereby exceeding the mid-year budget target of GH¢21.16 billion for the period by GH¢1.95 billion. Given the behavior of revenue and grants in the first three quarters of the year, this projected outturn appears unrealistic.

We therefore think that total revenue and grants outturn for 2021 will most likely be less than the reprogrammed amount of GH¢70.35 billion. This outcome would have two main implications. First, it would call for further cutbacks to planned expenditure if the 2021 deficit target is to be realized. Second, it would affect the feasibility of the 2022 budget's revenue mobilization target, since this target assumes that the government would attain what we consider to be an overoptimistic total revenue projection for 2021.

3. THE 2022 BUDGET: HOW CREDIBLE ARE THE REVENUE AND EXPENDITURE TARGETS?

Like the 2021 budget, the 2022 budget is a consolidation budget that is aiming to reduce the fiscal deficit from the projected outturn of 9.4% of GDP in 2021 to 7.4% of GDP in 2022. To accomplish this reduction, the government is targeting total revenue and grants of GH¢100.52 billion, representing a whopping 42.9% increase over the projected outturn for 2021. In terms of GDP, the targeted increase is 4 percentage points, which would take total revenue and grants to 20% of GDP in 2022. Total expenditure (including arrears payment), on the other hand, is estimated to rise over the 2021 projected outturn by 23.2% to GH¢137.53 billion. This growth in expenditure is equivalent to 2.1 percentage points of GDP, and would push total expenditure to 27.4% of GDP in 2022, compared with projected outturn of 25.3% in 2021. Thus, the consolidation plan in the 2022 budget is entirely revenue-based, as the expenditure-to-GDP ratio is expected to increase above the 2021 level. What this means is that the credibility of the 2022 fiscal consolidation hinges critically on the credibility of the targeted revenue collection.

Our assessment of the budgeted revenue of GH¢100.52 billion, again representing 42.9% growth over the projected outturn for 2021, is that it is also overambitious and not likely to be met. This is because if even we assume that the newly proposed electronic transaction levy would yield its forecast revenue of GH¢6.96 billion, the implied expected revenue growth in 2022 is 33%, which will be difficult to achieve. We conclude so not only because this growth rate diverges from recent historical trends, but also because the forecast growth rates of revenue from certain key sources, like taxes on income and property (33%) and non-tax revenue excluding oil (61%), are not adequately supported by policy measures in these areas.

What makes the 2022 revenue target even more difficult to be achieved is the high likelihood that the 2021 projected revenue would be undershot, as earlier argued. Such an outcome would mean that for the 2022 budgeted revenue to be achieved, revenue would have to grow by more than the already discussed overambitious rate of 42.9% in 2022.

The weak credibility of the 2022 revenue target calls into question the credibility of the expenditure programme and the envisaged consolidation. This puts the fiscal deficit target of 7.4% of GDP at risk of not being met unless the government resorts to unplanned spending cuts in the course of the budget's implementation. As usual, capital expenditure would likely bear the brunt of the cuts. It should be noted, however, that capital expenditure (by both central government and statutory funds), which stood at an average of 58% of government revenue in 1993–2000, has fallen consistently since then, reaching a record low average ratio of 23.3% of revenue in 2017–2020. This reduction has undermined the country's ability to rapidly close its infrastructure deficits. Further cuts to capital spending will, therefore, worsen the situation.

4. ASSESSMENT OF KEY POLICY INITIATIVES

We now turn to the budget's policy initiatives, with a focus on the two most notable policy announcements: (1) The YouStart Initiative; and (2) The Electronic Transaction Levy (E-Levy).

4.1 THE YOUSTART INITIATIVE

To help tackle youth unemployment by promoting youth entrepreneurship in the country, the government unveiled the YouStart initiative in the 2022 budget. This initiative, according to the government, is aimed at "supporting young entrepreneurs to gain access to capital, training, technical skills, and mentoring to enable them launch and operate their own businesses." It is projected that YouStart, to which the government has allocated GH¢1 billion in the 2022 budget and pledged additional GH¢2 billion in 2023–2024, is expected to result in the creation of 1 million jobs within the next three years.

We view the YouStart Initiative as a worthy intervention by the state to expand employment opportunities for the youth. Such opportunities are currently limited, giving rise to high youth unemployment and underemployment in the country. Entrepreneurship is a vital source of production, job creation, and innovation in any economy. Therefore, the YouStart initiative, which is intended to provide funding and other assistance to aid the development of start-ups and entrepreneurial ventures by young people, has the potential to improve economic growth and employment generation in Ghana.

However, for YouStart to be successful and avoid the failures that similar initiatives suffered in the past, the program needs to be effectively and sustainably managed. This would require targeting the YouStart support to entrepreneurial ventures or business proposals that have been rigorously vetted to ascertain their viability and sustainability, as well as their contribution to the broader development strategy of the nation. It would also require keeping partisan and political interferences at bay in managing or implementing the initiative, since these are sure ways to encourage wastage and corruption, which would ultimately cause the program's failure.

4.2 THE E-LEVY

Ghana clearly needs to dramatically increase revenue mobilization in order to help bring down the fiscal deficit, decrease the rate of debt build-up, minimize the excessive debt service burden the country is currently shouldering, and ensure fiscal sustainability. Sizeable increase in revenue would also grant the government the opportunity to significantly increase public investment, which is central to the country's quest for accelerated economic growth and development for the general socioeconomic wellbeing of Ghanaians.

We at IFS understand that it is to these effects that the government has proposed to impose the Electronic Transaction Levy or E-Levy of 1.75% on electronic transactions covering "mobile money payments, bank transfers, merchant payments, and inward remittances" to be borne by the sender, except inward remittance, which would be borne by the recipient.

It should, however, be noted that taxes/levies are imposed on incomes (including gifts), consumption, and properties or assets. Electronic transfers/payments are none of these. An electronic transfer usually represents a mere mode of payment or settlement. Indeed, modes of payment should not attract taxes/levies. This is because taxing modes of payment would:

1. Lead to instantaneous double taxation, since the underlying income, commodity, property, etc. the mode of payment is being applied to would have normally been taxed already.

2. Involve taxing the payment of another tax in many instances.

These make the proposed E-Levy problematic. Perhaps, an example will make things clearer. Suppose a consumer purchases groceries from a supermarket worth GH₵200. Since this amount includes VAT, using an electronic transfer as a mode of payment, instead of cash or check, would imply paying the proposed E-Levy in addition to the VAT. What makes it worse is that since the VAT component of this amount is a tax being paid to the government, charging E-Levy on the said amount also implies paying levy on the VAT component as well. Why should people be taxed on the tax they pay to the government?

In any case, why is the electronic mode of payment being discriminated against (in favor of cash and check) by making it more costly to Ghanaians? Is it the policy of the government now to discourage the digital economy and encourage the cash one, contrary to the digitization drive the government has been promoting in recent years? The government should have taken a lesson from the problems the other African countries (Malawi, Ivory Coast, Uganda and Congo) that introduced similar levies faced. In an article published in 2020, Global System for Mobile Communication Associations (GSMA), for instance, reports about the problems that these African countries faced when they introduced the levies as follows:

"… two outcomes have resulted: policy reversal and unintended negative consequences of the tax… In Malawi, the tax was withdrawn after announcement but before implementation; in Cote D'Iviore, the tax was changed so that it was absorbed by

the MMPs and not passed onto users; in Uganda, the tax rate was reduced and the transactions it applied to narrowed. In Congo, there was much confusion about who the tax applied to."

5 RECOMMENDATIONS

In view of the above assessment, we make the following recommendations:

I. As stated earlier, the E-Levy is a problematic tax, and should therefore not be proceeded with, at least not in the form in which it has been proposed in the budget.

II. Having assessed the 2022 budget's revenue and expenditure projections as not being credible, we urge the government to adopt a conservative stance when implementing the budget if approved. This should be done by using more conservative revenue estimates than those contained in the budget to guide spending.

III. Since capital spending has fallen to incredibly low levels in recent years, contributing to persistent large infrastructure deficits, the government should ensure to protect capital spending from further reductions even as it undertakes much-needed fiscal consolidation, given that the revenue target is not likely to be met as argued earlier. This would require making hard choices to reduce spending on compensation and goods and services so as to prevent capital spending from bearing the brunt of expenditure cuts.

IV. To substantially increase revenue mobilization, we advise the government to turn its attention to the extractive sector of the economy, where revenue received by the government of Ghana as a ratio of the value of output produced in the sector pales in comparison to the ratios received by peer countries in the developing world. Indeed, Ghana has the potential to close its revenue gaps in relation to peer countries by enhancing extractive sector revenue mobilization. For further details and recommendations to achieve this, we refer the government to the Institute for Fiscal Studies' (IFS) Occasional Paper No. 24, entitled *"The Role of the Extractive Sector in Ghana's Comparatively Low Public Sector Revenue Mobilization"*.

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Residential Address
No. 13, 2nd Close, Airport Residential Area, Accra, Ghana

Postal Address
P.O. Box CT 11260, Cantonments, Accra, Ghana

+233 302 786 991
info@ifsghana.org
www.ifsghana.org