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PRESS RELEASE

Entrenching fiscal responsibility in Ghana through fiscal rules and a fiscal council

1. Introduction

Ghana's fiscal management has a familiar story. It has long been characterised by sizable deficits—as revenue consistently lags behind expenditure. The deficits are financed largely by borrowing domestically and externally. The direct consequence of this has been macroeconomic instability, manifest in persistent inflation, currency depreciation and unsustainable debt. Periodically, the economic situation reaches a crisis point, leading to loss of policy credibility and confidence by the international community. This precipitates disinvestments from domestic financial assets, leading to outflow of foreign exchange (FX), lowering of Ghana's credit rating and widening of the country's sovereign debt spreads or cost of borrowing. Restoring the economy to normalcy would normally require severe fiscal adjustments requiring tax increases and expenditure cuts, which would entail economic hardships. Lacking the boldness to take these measures—and knowing that the markets may not trust our own policy credibility—we turn to the IMF for financial bailout. The bailout is normally supported by a program that is invariably conditioned on stringent—and often socially-costly—measures, including expenditure cuts, tax increases, removal of subsidies, increases in utility tariffs and public sector employment freeze.

Since 1966, Ghana has sought IMF bailouts seventeen times, averaging one bailout every 3 ½ years. This is a record that we cannot not be proud of. The fact is that unlike monetary policy, which operates with a rule, such as limits on monetary growth, which helps to anchor the ultimate inflation target, fiscal policy is largely conducted on a discretionary basis and seems to lack a definite, well-defined anchor regarding fiscal and debt sustainability. What the IMF program essentially does is to remove the policy discretion during the program period, impose rules—such as deficit ceilings and limits on monetary financing—and provide the necessary anchor. The programs often restore the needed stability but this may also occur at the expense of growth largely because of its fiscal-retrenchment bias. Meanwhile, the programs are followed repeatedly by a return to fiscal profligacy and consequent macroeconomic instability and unsustainable debt—and the cycle repeats itself!

Obviously, we cannot continue to do the same things and expect different results. Many prudently-managed economies operate within rules that limit fiscal policy discretion and arbitrariness. The rules provide the needed anchor regarding fiscal and debt sustainability. The closest we have come in terms of adopting fiscal rules have been: i) The option given to the Minister of Finance in the Public Financial Management Act (PFMA) to propose specific numerical fiscal rules, and ii) The imposition of a ceiling of 5% on the fiscal deficit in the Fiscal Responsibility Act (FRA). While the FRA deficit ceiling may be regarded as the Minister's response to the PFMA requirement to introduce a policy rule, the ceiling operated for just 2018-19. In 2020, the Minister suspended it, citing Covid-19 to invoke the "Escape Clause Mechanism" in the FRA. The suspension of the rule culminated in a deficit of over 15% in 2020 and eventual return to the IMF for a bailout, supported by an Extended Credit Facility (ECF) program spanning 2023-26. The need to return to fiscal rules has become urgent so that we can entrench fiscal responsibility on our own and, thereby avoid returning to the IMF yet again—at least not in the foreseeable future, as we cannot say, never.

Another major lapse in fiscal policy has to do with the lack of a strong analytical framework and an effective monitoring and oversight mechanism. Fiscal policy appears to be formulated more or less on an ad-hoc basis unsupported by a well-grounded framework tailored to safeguarding macroeconomic stability and fiscal and debt sustainability. Further, Parliament seems to lack the time and requisite expertise to conduct a thorough and effective analysis and oversight of the budget, thereby allowing deficiencies, inefficiencies and, often, corrupt practices, to prevail. Indeed, Parliament even often fails to enforce its own Appropriations Bill that approve annual Government spending, allowing overruns to occur incessantly and with impunity. This is where

a Fiscal Council (FC), comprising independent experts and adequately resourced, can play a role (as we elaborate in Section 3 below). The closest we have come to adopting an FC is when the President established a Fiscal Policy Advisory Council (FPAC), following the enactment of the FRA. However, as we explain in Section 3, the FPAC is not an FC in the true sense of the word, especially because of its lack of independence from the Executive.

The IEA has worked and published extensively on Fiscal Rules and Fiscal Councils as its contribution to the search for durable fiscal responsibility and fiscal discipline in Ghana. We are aware that discussions are currently going on between the IMF and the Ministry of Finance towards designing Fiscal Rules and a Fiscal Council to help underpin fiscal responsibility in Ghana. We are issuing this Press Release as our contribution to these discussions. We demonstrate in the following Sections that, based on international best practices, instituting Fiscal Rules and a Fiscal Council would be the best way to anchor fiscal policy and macroeconomic stability internally and permanently and, thereby, help position Ghana beyond IMF bailouts.

2. Fiscal Rules

A fiscal rule is a permanent constraint on fiscal policy through simple numerical limits on budgetary aggregates. This definition implies that boundaries, which are difficult to change frequently, are set for fiscal policy and some operational guidance is provided by specifying a numerical target that limits a particular budgetary target.

Fiscal rules take several forms, serving different objectives; but, basically, they aim at fostering fiscal and debt sustainability. Fiscal rules include, but are not limited to: **budget balance rules, debt rules, expenditure rules and revenue rules.**

Ghana passed a Public Financial Management Act (PFMA) in 2016 to help entrench fiscal responsibility, macroeconomic stability and debt sustainability. The PFMA provides guidelines and rules for public financial management with responsibilities for relevant public office holders. As mentioned above, the PFMA gives the option to the Minister of Finance to propose specific numerical fiscal rules in the Fiscal Strategy Document (FSD) that he is required to prepare and submit to Cabinet annually. Subsequent to the enactment of the PFMA, Government passed a Fiscal Responsibility Act (FRA) in 2018. Among others, the FRA caps the overall budget deficit at 5% of GDP. The reasons for the 5% deficit rule are, however, not spelt out. The ultimate test, however, is whether it is consistent with fiscal and debt sustainability. IEA's own study in 2014 determined that an annual average deficit of 4% could deliver a debt/GDP of 50% by 2020, which would be a sustainable level. ECOWAS and the West African Monetary Zone (WAMZ) and have set a fiscal deficit ceiling of 4% and 3% respectively for their members. We would recommend the more stringent ECOWAS ceiling of 3% for Ghana, which has a greater chance of delivering debt sustainability than the current 5% in the FRA. But even to buttress the deficit rule, we would propose two additional rules—a debt rule and a borrowing-investment rule. The debt rule should cap the debt/GDP at 60%, deemed a sustainable threshold for middle-income countries, such as Ghana. The cap should apply on a continuous basis. As in the current FRA, both the deficit and debt caps should be subject to: a) Escape Clause to cater for unexpected shocks and emergencies; b) Automatic Correction Mechanism to correct for deviations from the rule; and c) Periodic Reviews of the rule in line with changing economic conditions. However, the caps should be subject to Parliamentary approval for invocation of the above provisions and, in particular, a timeframe must be set by Parliament for restoration of the caps should they be breached. The borrowing-investment rule, on the other hand, should require that borrowing be used solely for investment, with none going to recurrent (or consumption) spending. This rule is to ensure that loans are applied to productive projects, making it possible to generate enough returns for future repayments, while engendering economic growth and employment creation.

3. Fiscal Council

A Fiscal Council (FC) is an independent body usually set up by governments to evaluate fiscal policy. Fiscal Councils can make a significant contribution to good fiscal policy provided that they are established in a form which guarantees their independence. To be an effective agency of fiscal restraint, the FC should be able to exercise independent watchdog role over executive formulation and implementation of fiscal policy. FC independence is especially important for Ghana and other developing countries where institutional checks and balances over policy tend to be weak.

But, what exactly are FCs meant to do? Are these institutions similar in structure across countries? Are they an alternative or a complement to fiscal rules? A study that compared the activities of eleven FCs notes that, at first sight, these bodies appeared very diverse. The US and Dutch FCs have over 150 staff each (the US FC has 235 staff). But some others have small staff—largely comprising "Council Members." Around half focused only on fiscal policy, while others also provided analysis of employment, growth and other structural policies. While most just consider macroeconomic issues, the two councils in North America (i.e. US and Canada) also undertake analysis of particular spending projects. However, there were some interesting commonalities among the FCs. All of them provide some form of ex-post and ex-ante evaluation of fiscal policy and long-run fiscal sustainability. Unlike independent central banks, however, no FC has any formal power to decide the national deficit—this is where a fiscal rule may be relevant. Instead, they provide advice of various kinds by producing forecasts or evaluating government policies.

As problems with deficits and debt have taken hold, FCs have become increasingly common. However, FCs are more common in developed economies than in developing countries, where fiscal challenges even tend to be more dominant. In Africa, in particular, FCs are few. The Parliamentary Budget Office (PBO) of South Africa, which provides independent and objective economic and fiscal analysis to Parliament, is, probably, the most well-known FC in Africa. Ghana has flirted with establishing an FC, but does not as yet have a world-standard one in place. After the FRA was passed in 2018, the President announced the formation of a Fiscal Policy Advisory Council (FPAC). The FPAC comprised seven members and was charged with the mandate to: "*Develop and recommend to the President fiscal responsibility policies for the maintenance of prudent and sustainable levels of public debt, ensuring that the fiscal balance is maintained at a sustainable level, and the management of fiscal risks in a prudent manner, to achieve efficiency, effectiveness and value for money in public expenditure.*" The FPAC is, however, not a true FC to the extent that it is only an advisory body to the President who appointed the membership and funds the Council, potentially undermining its independence, neutrality and objectivity. Parliament has also been considering establishing a Parliamentary Budget Office (PBO), akin to an FC, with bi-partisan support. However, it is unclear how that effort is progressing, and the supporting law is yet to be enacted.

In order to find a suitable Fiscal Council model for Ghana, we compared three best examples—the US Congressional Budget Office (CBO), the UK Office for Budget Responsibility (OBR) and the Swedish Fiscal Policy Council (FPC). The three were seen to have some commonalities, especially regarding the functions they perform. They engaged mostly in: i) economic and fiscal forecasting, ii) evaluation of fiscal performance against targets, iii) evaluation of fiscal risks, iv) assessment of consistency of fiscal policy with long-term fiscal and debt sustainability and sustainable growth, and v) publication of briefing materials to inform the public about their work. However, the OBR appeared unique to the extent that, it produces the official forecasts on which government decisions are made. This implies that the OBR has a direct input into government policy. The three Fiscal Councils differ fundamentally in the sense that whereas the CBO is more or less a Congressional creation and works closely with Congress, the OBR and FPC were established by Governments of those countries and work more closely with the Governments. FCs differ in their structure and functions from country to country.

Regarding who appoints or establishes the FC, we saw a bias towards government (for example as in the case of the UK OBR and Swedish FPC) as against parliament (as in the case of the US CBO). In spite of this bias, we would still suggest that Ghana's FC should not be appointed by the President/Government precisely because of the risk of excessive Executive influence. In the countries where the FC is established or appointed by the Government, they have strong checks and balances that can prevent Executive influence over the FC. In Ghana, and indeed in many other developing countries, however, checks and balances tend to be weak. In view of this, we recommend that the FC be appointed through a competitive Parliament-cum-Public Services Commission recruitment process. It is important to have an FC composed of independent professionals or technocrats. In other jurisdictions, including the US, the FC is attached to Parliament/Congress, not the Executive. This model is particularly helpful for Ghana—and, indeed, other developing countries—because

Parliament tends to lack the necessary capacity and time to conduct in-depth analysis of Government policy and to carry out its oversight mandate effectively.

When it comes to the functions of the FC, the international practice shows quite a variation, dependent on individual country circumstances. Making recommendations in that regard is therefore, difficult. However, seeping through the international models, there are some functions that seem common and pertinent (as, for example, we saw for the US CBO, UK OBR and Swedish FPC). On that basis, we anticipate the Ghanaian FC to have the following functions: A) Carrying out analysis of Government's budget to ensure credibility of the underlying macroeconomic assumptions and framework and consistency with macroeconomic stability and debt sustainability; B) Providing independent budget forecasts; C) Assessing budgetary outcomes and potential risks; D) Providing alternative estimates of the costs of government projects and programs; E) Monitoring budget implementation; F) Monitoring the Fiscal Rule; and G) Providing periodic reports on budget execution and the economic situation for information of the public.

Given the complexity of tasks that the FC has to perform, it must be well-resourced in a technical sense. That's why the appointment/recruitment process has to be rigorous. The membership must necessarily include persons with proven expertise in economics, public finance, statistics or allied disciplines. How FCs are resourced financially is an important determinant of their operational independence. Ideally, ensuring the autonomy of the Ghanaian FC requires that its budget is directly appropriated by Parliament—not the Executive—and charged to the Consolidated Fund. It is commonplace in this country to find independent governance watchdogs deprived of public funds they need to carry out their mandates effectively, which highlights the need for Executive funding of the FC.

4. Summary of Recommendations

The main advantage of a rules-based fiscal policy is that it introduces automatic discipline in its conduct by fixing relevant budgetary aggregates, which may also reduce economic uncertainties and volatilities.

Fiscal Rules

We recommend the following:

- An overall deficit ceiling of 3% of GDP.
- A public debt ceiling of 60% of GDP (on a continuous basis).
- Both rules must be subject to Parliamentary approval for breaches and duration for their restoration after they are breached.

Fiscal Council

We recommend the following:

- The Fiscal Council should be appointed by the Public Services Commission and approved by Parliament.
- The Council should comprise experts in economics, public finance, statistics or allied disciplines.
- The Council should be directly funded from the Consolidated Fund.
- The Council should be responsible for functions enumerated in Section 3.

Fiscal Responsibility Framework

We recommend the following:

- The Fiscal Rules, Fiscal Council and Public Financial Management Act should be integrated into a single, focused Fiscal Responsibility Framework.
- Parliament should strictly enforce its Appropriations Acts that approve spending limits for Government to reinforce adherence to the Fiscal Rules.
- The Fiscal Responsibility Framework should specify clear guidelines for sanctioning breaches of its provisions.

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