

**TIRP and the IMF Enhanced Structural Facility Framework
for 1999-2001**

June 1999



Sigma One Corporation

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Sigma One Corporation (U.S. Office)
Post Office Box 12836
Research Triangle Park, North Carolina 27709-2836

Phone: (919) 361-9800

Fax: (919) 361-5858

Email: sigma1@sigmaone.com

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Barbara Pietuch

14. Telephone Number

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**TIRP and the IMF Enhanced Structural Facility Framework
for 1999-2001**

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In fulfillment of the following milestones:

- 2.8 Quarterly briefs on monitoring and evaluation of events in relation to targets with IMF and other donors.**

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The TIRP Policy Agenda and the Enhanced Structural Adjustment Facility Policy Framework Paper (PFP), 1999-2001: Potential Areas of Collaboration

The policy reform component of the TIRP supports a wide-ranging policy agenda. That this agenda reflects Government of Ghana priorities can be seen from a review of the policy agenda presented in the recently signed Enhanced Structural Adjustment Facility Policy Framework Paper (PFP), 1999-2001. In a number of areas, achievement of the TIRP policy agenda results in the achievement, in whole or part, of the policy objectives specified in the PFP. The following discussion presents areas where the TIRP policy agenda is reflected in the PFP.

TAXES

PFP. The Government hopes to increase the revenue-to-GDP ratio to 19% over the medium term. The measures suggested in the PFP to meet that objective are:

- monitor the performance of the VAT and adjust the rate if necessary;
- undertake efforts to cut back tax and tariff exemptions;
- reduce the top tariff rate so as to remove distortions and improve equity;
- strengthen tax administration and improve collection procedures and audit practices.

TIRP. The TIRP policy agenda identified the rationalization of the tax and revenue system as a priority area. In addition to support for the VAT, areas identified for attention were:

- recommend initiatives to improve the system of collecting taxes of all kinds;
- review exonerations and exemptions which are leading enterprises to reclassify economic activities to avoid taxation;
- develop estimates of tax elasticities for various types of taxes;
- analyze the effect of alternative tax measures on Ghana's international competitiveness;
- analyze the effect of tax policy on the size and rate of growth of the formal sector;
- analyze the disincentive effects of import tariffs and export taxes on production and exports;
- develop mechanisms to improve the efficiency of present and alternative administrative collection procedures;
- assist CEPS to conduct an internal review of operations;
- assist the Ministry of Finance to develop an action plan to increase tax collections from self-employed Ghanaians.

Status of TIRP Activities. Under the TIRP several tax and revenue activities have begun. In September, 1998 a Sigma One Corporation consultant reviewed VAT dispute resolution procedures and made recommendations to strengthen them. In March 1999, two consultants reviewed collections procedures at the IRS and are developing a Collection Procedures Manual for training of the IRS staff. The draft manual will be available in May and, once approved, the

consultants will return to undertake a training of trainers course in Accra for the IRS. In May 1999, a Sigma One Corporation tax consultant, in collaboration with the Ministry of Finance, the IRS and CEPS developed a draft work program to support Ghana's tax reform. The program focuses on policy and administrative reforms in CEPS and IRS, as well as supporting institutional development for the National Revenue Board, Dispute Resolution, Revenue Estimation, Data Analysis and Management Information Systems. This program covers the two year period from July 1999 to June 2001, and would provide 60 person months of assistance. Three of the four areas of the PFP tax program are included in the TIRP tax proposal, viz.:

- cut back on tax and tariff exemptions;
- reduce the top tariff rate so as to remove distortions and improve equity;
- strengthen tax administration and improve collection procedures and audit practices.

EXPENDITURE MANAGEMENT AND CONTROL

PFP. For 1999 the Government adopted a Medium Term Expenditure Framework as the basis for the 1999 budget, and will continue to use this framework for the future. The exercise covers all ministries, departments and agencies (MDAs). All government resources, including external financing, have been accounted for in the budget preparation guidelines, and all personnel expenses, including allowances, have been consolidated. Line ministries and agencies have based their expenditure plans on operational targets, which will facilitate the ex post assessment of performance. A new accounting framework has been adopted that allows closer monitoring of expenditures. Development of a computer-based Budget and Public Expenditure Management System (BPMS) has been commissioned, which is to be fully operational by end-2000. To resolve the continuing problem of the accumulation of large payment arrears to road contractors, the Government will terminate a number of contracts, scale down domestically financed road projects, revise procedures for initiating projects, and award contracts in line with World Bank procurement rules.

TIRP. The TIRP has resources to assist the Government in its expenditure management and control efforts. Areas proposed for assistance by Sigma One Corporation include:

- providing technical assistance, training and necessary software support to assist the Expenditure Monitoring Unit of MOF to improve production of monthly and quarterly Government expenditure reports;
- providing technical assistance to the Aid and Debt Management Unit of the MOF to improve procedures for data capture of donor flows;
- providing assistance to the MOF and principal infrastructure agencies, such as MRH and MWH, in review of capital projects and prioritize them in the context of the Medium Term Expenditure Framework (MTEF);
- assisting in the review of contracts and procurement procedures to limit cost overruns; and
- assisting in the development of new mechanisms for compensating for unanticipated price changes and revise contingency provisions to cater for inflation.

Status of TIRP Activities. Activities have been initiated in several of the areas of which some are ongoing. Assistance has been provided to the Expenditure Monitoring Unit (EMU) of the MOF. An expenditure monitoring system has been installed that provides the MOF and other spending agencies with monthly expenditure reports on a timely basis. Long-standing software difficulties had frustrated the EMU's attempt to process the data generated by the BOG. The technical problems were resolved by the staff of Sigma One Corporation, but new problems have appeared. With the introduction of the Magnetic Ink Character Recognition cheques, the BOG is no longer able to provide expenditure data in electronic format. Currently Sigma One is working with the Controller and Accounting General (C&AG) Office to provide the data to allow comparison and analysis of spending patterns.

A workshop was organized at Sigma One Corporation's office in Accra to discuss with senior staff of the Ministry of Roads and Transport and the Ghana Highway Authority criteria for prioritizing road projects. Subsequent meetings were held with the Minister and Deputy Minister of Roads and Transport to discuss support that Sigma One could provide for the review of contract procedures. The Ministry was considering setting up a Committee to review the ongoing projects. Sigma One agree to finance, on request, a contract specialist to join the team. The discussions also included the subject of reviewing contract and procurement procedures. The Ministry proposed to first resolve problems with existing contracts. The Review Committee, if created, could provide recommendations on how to deal with contract and procurement issues in the future.

MONETARY MANAGEMENT

FFP. The PFP states the main goal of monetary policy in 1999 is to reduce inflation to not more than 9 percent by the end of the year and 5% in the subsequent two years. Consistent with that objective and the expectation that real GDP will grow by 5.5 percent in 1999, the Bank of Ghana will aim at limiting monetary growth this year to 14.5 percent. The monetary growth target will be achieved by limiting reserve money growth to 11.5 percent through the use of indirect monetary policy instruments, including repurchase agreements. The Bank of Ghana expects that price trends and the performance of the economy will allow interest rates to fall during the year, but it will adjust policies as needed to meet monetary targets. Bank financing of the budget is projected to expand by no more than C210 billion, or the equivalent of about 1 percent of GDP, which would allow credit to the private sector to grow by 17.5 percent in 1999, broadly in line with nominal GDP.

The exchange rate will be determined by market forces, generally in tandem with price trends in Ghana and in partner countries. The Bank of Ghana's intervention policy will be directed at meeting the program target for net foreign assets (for 1999, the BOG has targeted an accumulation of net foreign assets of \$77 million). The BOG will continue to take steps to deepen domestic and foreign exchange markets, and will assess the scope for future modification of the

surrender requirements.

TIRP. Potential areas of assistance identified in the TIRP project for support in monetary management are:

- assisting in the implementation of a secondary market for monetary instruments;
- assisting in the design and implementation of a forward market for foreign exchange;
- assisting in the design and implementation of a "soft band" targeting system for exchange rate management; and
- assisting in coordination of monetary and fiscal policies.

Status of TIRP Activities. Selected TIRP activities have been initiated in this area. Sigma One Corporation is collaborating with the Ghana Stock Exchange and the Bank of Ghana in hosting a Conference on development of a Futures Market in Ghana. This will include discussion on the issues of design and implementation of a forward market for Foreign Exchange. The Competitiveness Study due to start soon analyzes macroeconomic policies as they affect the competitiveness of the Ghanaian economy. The study will analyze trade, fiscal, financial and exchange rate policy as they impact on the economy and the real markets.

Under the precursor activity to TIRP, Sigma One Corporation collaborated with the Bank of Ghana in the development of a secondary market for monetary instruments. Sigma One Corporation funded a team from the BOG to visit ongoing secondary market operations in South Africa and Chile.

TRADE POLICY REFORM

PPF. As part of the PPF, the Government will continue to review the tariff structure, with a view of enhancing the external competitiveness of local industry, harmonizing tariff rates with regional practices and removing distortions. To prevent smuggling, the Government will reduce the top tariff rate to the target set by the West African Economic and Monetary Union (20 percent), in the context of the 2000 budget. While taking steps to curtail exemptions, the Government will gradually reduce the average tariff rate over the next three years to less than 10 percent. The special tax of 17.5 percent on certain imported goods was abolished in March 1999. At the same time, the Government is implementing the Gateway Project aimed at removing constraints to trade. The Gateway Project has ambitious targets for improving the efficiency of the Ports and improving Ghana's competitiveness.

TIRP. Under the TIRP, a number of areas have been identified for policy analysis and reform in the Trade sector. These include:

- assisting in the design and implementation of a program of rationalization of trade duties and tariffs to make the trade regime neutral across sectors as part of the process of broadening the base of taxation and promoting neutrality;

- assisting MOTI to review and update calculations of effective protection for leading industries and interpreting the implications for trade policy and international competitiveness;
- assisting MOTI, MOFA and the Ministry of the Environment Science and Technology (MEST), to reduce controls on importation of agricultural and manufacturing inputs balancing efficiency issues with legitimate concerns about safety and the environment; and
- assisting in the analysis of the relative competitiveness of the Ghanaian timber industry and development of a consensus on policies affecting the production and export of wood products.

Status of TIRP Activities. Under the predecessor activity to TIRP, Sigma One Corporation assisted MOTI to review and update calculations on effective protection for leading industries. This analysis needs to be updated and the calculations monitored. Under the competitiveness study, analyses of the agricultural and industrial sectors will provide further insight into the effect that macro economic and sectoral policies have on Ghana's international competitiveness. Under TIRP, Sigma One has proposed a joint project between CEPS and MOTI that would examine tariff levels, suggesting revisions, while addressing the issues of balancing the protection, revenue and competitiveness concerns of Government. The Trade and Export Development Task Force set up under the TIRP will coordinate this policy analysis and the implementation of the above activities, ensuring that they are consistent with the PFP agenda.

COCOA SECTOR REFORMS

PFP. The PFP presents an ambitious program of policy reform for the cocoa sector. The objective of the cocoa strategy is to ensure better performance of the industry and increase farmers' income. Its highlights include:

- increasing producer prices to at least 60% of the f.o.b. price for the 1999/2000 season and by at least 2 percentage points in each of the next two years;
- reducing the tax on cocoa from the current level of 26% of the f.o.b. price;
- allowing qualified licensed buying companies (LBCs), including the Produce Buying Company (PBC), to export at least 30 percent of their domestic purchases, starting with the 2000/01 crop;
- giving LBCs equal access to Cocoa Marketing Board (Cocobod) warehouses and crop financing;
- abolishing price discounts on exportable cocoa to domestic processors.

The attainment of this ambitious program of action will require the development and application of a number of measures that will support the transition from a parastatal directed sector to a private sector market-oriented industry.

TIRP. The TIRP has, as one of its milestones the analysis of constraints to increased export production of traditional products. As part of this analysis, it was proposed that Sigma One

Corporation would review the policy constraints which affect expansion in cocoa production. This review would include the effect of financial and exchange rate policies on the international competitiveness of the cocoa sector.

Status of TIRP Activities. Under the TIRP project, a study was conducted on the issue of "Competitiveness and Reform in Ghana's Cocoa Industry". The report identified critical issues that would have to be effectively managed if the ongoing cocoa reform program was to be successful. From these issues two areas were identified as being especially relevant to the TIRP project, viz.:

- The Cocoa Task Force recommended that cocoa export taxes be reduced to approximately 15% of f.o.b. prices by 2004/5. The timing, implementation and impacts of tax reduction need to be fully understood and planned for, so as to avoid budget revenue shortfalls that could put pressure on interest rates and/or on inflation. The Policy Reform and Financial Intermediation component of TIRP could examine likely timing of tax revenue losses and gains under the system, given assumptions regarding tax rates and supply elasticities, and provide assistance in the design and implementation of alternative tax revenue mechanisms (as part of the tax agenda discussed above).
- Financing issues must be addressed if the cocoa reform process is to be implemented successfully. These issues relate both to financing production and marketing. The reform program assumes that production increases in the future will come from a shift from low technology to the use of improved technology in the form of purchased inputs, such as fertilizer, weedicides and pesticides. The use of these inputs implies a significant increase in demand for credit financing facilities for farmers. How to meet this demand is a challenge to the Cocoa Reform Program. Likewise, changes in marketing arrangements from parastatal to private sector buying of cocoa will require new financing arrangements. The financing required for internal marketing, assuming a production level of 500,000 mt in 2004/5 and a recycling factor of 2, would be about C880.0 billion (1998 cedis). Due to the large amount of funds required, no Licensed Buying Company (LBC) is in a position to adequately secure bank facilities. The LBCs face a ceiling on bank lending to individuals of 25% (secured) and 10 % (unsecured) of the banks net worth. This limits crop purchase for individual LBCs and poses a number of questions that must be resolved. In addition, there are limits on bank lending to any one sector that may also be a binding constraint. Will these ceilings lead to a financing gap in the event of privatization? How could/should a financing or credit guarantee mechanism be designed? These issues are related to financial intermediation questions that the Sigma One Corporation contract under TIRP is to address. Our resources can assist the Ministry of Finance in developing a financial sector strategy and the associated mechanisms required to finance the cocoa sector (farmers, LBCs, input suppliers, etc.).

In addition, to the above, cocoa has been included as one commodity, for this years report on the study of competitiveness of the Ghanaian economy. The analytical work to be undertaken by

ISSER, will evaluate the impact of government policies on the competitiveness of the economy.

LABOR MARKET REFORM

PFP. The PFP discusses a new wage structure that is being put into place for the public service. Given that the Government is by far the largest employer in the formal sector, this policy will impact significantly on the formal sector labor market. The Government is negotiating with the social partners a comprehensive long-term wage policy, aimed at reforming the pay structure based on a detailed job evaluation of the entire public sector. This is an ongoing process. In November 1998, a Central Management Board was constituted to oversee the introduction of a uniform salary and grading structure for the public service. The first phase, which involved regrading and reclassification of the entire public service, is complete. Negotiations on the implementation of the new salary structure are ongoing, and the Government intends to conclude them as soon as possible.

TIRP. The TIRP has a central policy thrust, to support activities to introduce greater flexibility into formal sector compensation, tenure and emoluments in ways that increase job creation and allow firms to optimize labor use. The TIRP approach is to facilitate workshops and focus groups with key players in the labor markets (government, employers, labor unions, selected parliamentarians, etc.) to assess the impact of reforms. This approach requires labor policy dialogue and, where necessary, the formulation of new labor legislation, codes and regulations. In addition to promotion of more flexible and efficient labor markets, Sigma One Corporation will assist the IMCC and the Ministry of Employment and Social Welfare to develop and implement a method of evaluating annual productivity growth in the economy as an indicator for use in wage negotiations.

Status of TIRP Activities. Two briefs on the Ghanaian labor market have been prepared. In February a seminar was presented at the Sigma One Corporation Accra office by Mr. Ralph Franklin of Sigma One, on the topic of the interactions between the labor market and the macro economy. Sigma One Corporation is also working with the planning group preparing for the National Labour Forum. Under the TIRP program, Sigma One Corporation will provide technical and financial resources in support of the Forum. Sigma One Corporation will also provide support, as requested to analyze and implement the recommendations of, as well as to help resolve issues arising from, the Forum.

AGRICULTURE SECTOR

PFP. The PFP recognizes the critical role of agriculture in the economy and discusses the Accelerated Agricultural Growth Strategy (AAGS), designed by the Government to create an environment that will enable the private sector to boost agricultural production, agro-processing and exports, and in the process, increase the agriculture sector's growth rate from the current 3-4 percent to 5-6 percent per annum. To do this, the PFP lists the following institutional reforms and investment initiatives to be carried out through the Agricultural Services Sector Investment

Program (AGSSIP), that will be launched in mid-2000:

- improving access to markets and promoting the production and export of selected products;
- facilitating access to agricultural technology;
- increasing access to rural finance;
- improving rural infrastructure and utilities; and
- enhancing human resources and building institutional capacity.

TIRP. The agricultural sector activities to be undertaken under TIRP were to be the result of actions identified by the Agricultural Sector Task Force under the leadership of Dr. Dapaah. Specific collaborative policy and financial intermediation activities include::

- specific analyses to demonstrate the commodity-by-commodity benefits from economy-wide reforms and further trade liberalization;
- a review of the food security situation to guard against the potential deleterious effects from further liberalization and promote more effective inter-regional linkages;
- an assessment of the rural credit system and the unmet investment needs to ensure that policies and financial intermediation activities maintain a sharp focus on agriculture;
- a review of land usufruct arrangements and enabling laws and regulations to promote fair and enforceable out grower and contract farming arrangements;
- an assessment of the regulations affecting input marketing with a view to promote more effective private sector participation while ensuring compliance with safety and environmental requirements and guaranteeing the quality of inputs available to farmers; and
- an assessment of the regulatory and policy framework for irrigation schemes with a view to placing them on a self-sustaining basis.

Status of TIRP Activities. At present the only ongoing agricultural sector activity is the analysis of commodity benefits from economy-wide reforms and further trade liberalization. The competitiveness study for 1999 is examining the impact of policy distortions on three commodities; cocoa, maize and cassava. This analysis will examine how macro economic and sectoral policies impact on the profitability and international competitiveness of these products. In 2000, three or more additional commodities will be selected for analysis and the current three will be updated. The Agricultural Task Force will review the proposed TIRP activities for the commencement on additional activities.

Financial Sector Reform

PFP. Under the PFP, the Government is taking immediate steps to restructure weak banks and divest public share holding in commercial banks. To ensure the efficiency and soundness of the financial system, the Bank of Ghana will:

- strengthen both on-site and off-site supervision procedures;

- ensure compliance with the capital adequacy ratio;
- monitor foreign exchange exposure.;
- review both the central bank law and the banking law in line with best international practices;
- strengthen its supervisory practices and bring prudential regulations in line with Basle Core Principles; and
- streamline regulations for entry and exit, and continue to assess applicants by strict professional and financial standards.

TIRP. Under the financial intermediation component of the Improved Policy Reform and Financial Intermediation component of TIRP, resources are available to assist the Bank of Ghana and the financial sector to do the following:

- review Ghana's Bank Supervision regulations and practices in the context of the "Basle Committee's Core Principles for Bank Supervision" to ensure that Ghana's banking system is placed on a path toward "best practice" international standards and competitiveness;
- monitor other country efforts to create international standards for banking (accounting standards, capital adequacy requirements, internal and external auditing, non-performing asset standards, etc.) for their applicability to Ghana;
- undertake a rapid assessment of the supervisory standards and regulations to determine if there are too many regulations, if so, the extent of over-burdening of the supervisory staff and negative effects on prudence and effectiveness.
- review needs for simplification in loan documentation and securities disclosure statements to assure prudence, transparency and due diligence while streamlining transactions;
- assist in bringing the Securities Regulatory Commission (SRC) into effective operation with training and technical assistance, if authorities request such support;
- assist, as necessary, in drafting amendments to the Non-Bank Financial Institutions Act and/or specific guidelines for the entire range of institutions in the law;
- through the IMCC, assemble a Financial Sector Working Group, composed of members from private and quasi-private financial institutions (bank and non-bank), representatives from key regulatory and policy making bodies, as well as selected client groups of the financial system to review the supervisory and regulatory practices affecting the performance of the financial system;
- assist the Ghana Stock Exchange to broaden products listed on the exchange and improve operations;
- provide assistance to develop a strategy for creation of credit rating agencies and other vehicles for insuring lending decisions are made on credit histories and current abilities to re-pay;
- review a range of potential financial innovations suitable for Ghana and convene a conference on financial innovations in the financial sector;
- assist the IMCC to convene a working group of all TIRP contractors and grantees to develop a strategy for mobilizing informal sector resources into productive investments;

- and
review SSNIT and other elements of the pension system with a view toward modernization.

Status of TIRP Activities. A draft scope of work has been prepared for the establishment of the Financial Sector Working Group and the IMCC has approved its creation. A review has been completed of the SSNIT and a draft report submitted to the Director General of SSNIT for his considerations. Terms of Reference are being drafted for a Financial Intermediation Task Force to address the Financial Intermediation policy agenda. Once this is established in June 1999, work will accelerate on the other components of the program. A workshop for the establishment of a futures exchange, organized by the GSE, BOG, SRC and Sigma One Corporation, with TIRP support, is scheduled for June 10-11, 1999. The workshop will address financial innovations relating to futures markets for commodities, financial instruments and foreign exchange, as well as the regulatory and institutional frameworks needed for the sound and efficient functioning of such markets.