POLICY BRIEF

Reforms for Special Drawing Rights (SDRs) Financing in Ghana's Economic Recovery

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Key messages

1. The covid-19 pandemic, rising external debt, and Russia-Ukraine war have exacerbated Ghana's economic woes, leading to unprecedented levels of macro-economic imbalances.

2. Ghana's economic recovery and quest for sustained growth require a cheaper source of finance, making the SDR a valuable option.

3. A review of the SDR allocation system, which makes allocation sensitive to needs and region-specific shocks, will save many countries in the global south including Ghana.

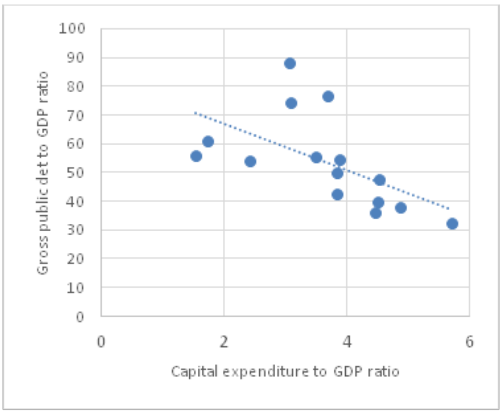
4. The government must implement innovative strategies to improve domestic revenue mobilization; ensure prudent fiscal measures; enhance efficiency in public spending; and eliminate political pride and propaganda regarding seeking help from the IMF.

What is the state of Ghana's economy?

The Ghanaian economy recorded its worst performance in the last three decades in 2022, evidenced by unprecedented levels of macro-economic imbalances. Although there were signs of fiscal slippages towards the end of 2019, the structural weaknesses in the country's fiscal domain were exposed and weakened by the triple *crisis – covid-19 pandemic, Russia-Ukraine war and rising climate shocks*. In addition, unsustainably high levels of public debt, especially rising external debt, has led to a steady increase in the amount of government revenues spent on servicing these debts. Spending an increasing share of the economy's revenues on servicing debt has resulted in declining shares for public investment in infrastructure and social services (see Figure 1 and 2). This appears to have had the tendency to induce the government to borrow more. In May 2023, the country was classified as debt distress by the IMF.

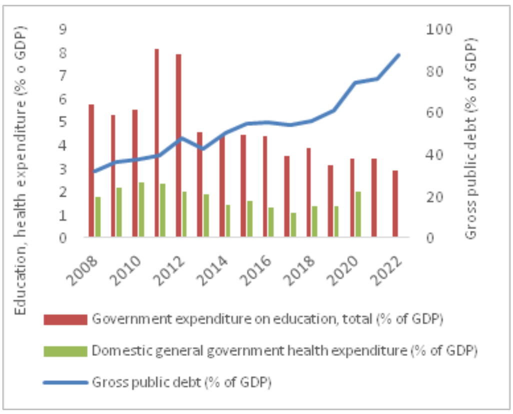
As part of measures to restore the economy to a sustained growth path, the government of Ghana initiated a negotiation with the IMF for a $3 billion programme (MoFEP, 2022) which required,

Figure 1: Scatter plot of Capital expenditure and public debt (% of GDP), 2008 - 2022



Source of data: Ministry of Finance; Bank of Ghana

Figure 2: Trends in public debt, health &education expenditure (% of GDP), 2008 -2022



Source of data: WDI, Ministry of Finance among other things, domestic and external debt restructuring. On May 17, 2023, the IMF Executive Board approved $3 billion (SDR 2.242 billion) 3-year Extended Credit Facility (ECF) arrangement for Ghana, and the first disbursement of about $600 million (SDR 451.4 million) was released immediately. The second tranche is expected upon a successful external debt restructuring. A meeting with Ghana's external creditors for talks on debt restructuring of about $5.4 billion is,therefore, scheduled for January 8, 2024.

Since the inception of the IMF-support programme, there have been some macro-economic gains. For instance, inflation was 26.4% in November 2023 compared to the 54.1% in December 2022; the cumulative depreciation rate of the Ghana cedi to the US dollar between January to September 2023 was 28.4% compared to the 49.4% same period 2022 (Bank of Ghana, 2023). Despite these strides and the recovery process in place, it is important to think about alternative sources of funds for sustained growth and development.

What financing options are available?

Since Ghana attained a lower-middle-income status in 2011, the country has been weaned off some overseas development assistance. Consequently, the international capital market (ICM) and multilateral arrangements have become the main sources for external funds. Unfortunately, with the unsustainable debt levels and consistent downgrades of the country by credit agencies such as Fitch, Moody's and Standard & Poors, Ghana was subsequently shut to the ICM (specifically the Eurobond market); thereby restricting the financing options available to the country. Meanwhile, domestic revenue mobilization has been persistently low due to structural constraints within the local economy. The reality, is there is very limited financing options available – borrowing domestically which may crowd out the private sector or resorting to multilateral/bilateral arrangements.

Why is SDR a crucial financing option?

Borrowing is almost inevitable for any country regardless of income status, but for a country like Ghana, strategic borrowing is necessary. Therefore, the recovery process needs a less costly financing regime, which offers lower interest rates than the rates on commercial loans for riskier countries.

Arguably, the SDR is a relatively cheaper alternative source of finance. The current SDR interest rate is about 4%, which is substantially cheaper than the 7–11% charged on Ghana's Eurobond. This makes the SDR a valuable option!

What is the issue?

Uneven SDR allocations: The SDR is characterized by uneven allocation because the allocation is based on a formula that is determined by member countries' quota or share in the Fund. For example, in the most recent allocations made in August 2021, two-thirds of the US$ 650 billion total allocation went to developed economies (specifically G20 countries), with the United States alone receiving 17%; although the SDR utilization by these countries have been historically low. Africa received only 5.12% of the total allocations, of which Nigeria and South Africa alone accounted for 1.16%; and Ghana's was about 0.1%.

Precarious conditions and desperate need for cheaper financing alternative(s): Many African countries (including Ghana) are in dire need of funds and have utilized their SDRs more than their allocations while the reverse is observed in some countries in the global north. Unfortunately, Ghana (like other African countries) cannot afford to go to the commercial market (even if it was still open to the country).

What policy reforms have we proposed?

A. SDR allocations

Rechanneling of unused SDRs to those who need them: Already, the IMF's Poverty Reduction and Growth Trust (PRGT) and Resilience and Sustainability Trust (RST) are important innovations to provide friendlier financing options for developing countries by tapping into SDRs for member states that do not use them. We suggest that this should be encouraged with the view to broaden their scope and promote full participation among all member states with unused SDRs.

Revision of how SDR allocations are made: As earlier indicated, the SDR allocations are made based on the quota system, which determine a member's share in a general allocation[1]. As a matter of principle, although this may seem right, the precarious conditions and limited financing options of countries in the global south, particularly in SSA, makes the SDRs a valuable option to be explored. Therefore, we recommend that the determination of a member's share should also take into account the "need" for funds by member countries.

Integration of region-specific shock: In the history of the SDR, there have been five allocations, made up of four general allocations (1970-1972; 1979-1981; 2009; and 2021) and a one-time special allocation (2009), of which the latter was made to benefit member countries who joined after 1981. Meanwhile, the general allocations have

1 https://www.imf.org/en/About/Factsheets/Sheets/2022/IMF-Quotas Accessed on January 6, 2024.

typically been in response to global shocks. The heterogeneities that exist across regions make some regions more predisposed to certain shocks (e.g., climate change, climate change adaptability challenges, conflicts) or may even exacerbate conditions which may further lead to disproportionate impact of global shocks. It will, therefore, be prudent for the allocation system to also pay attention to region-specific shocks, vulnerabilities and resilience capacity.

B. Domestic reforms

Intensify domestic revenue mobilization: Relative to the size of the economy, the amount of revenue generated has not improved at least in the last decade in Ghana. This is partly attributable to the extensive informality (over 70%) of the Ghanaian economy. Although efforts are being made to digitize the economy, tax administration should be more efficient to reduce the costs associated with tax collection. Intensified education on taxation should be targeted at the informal economy who are more likely to evade tax. Transparency and accountability in the tax system at all levels will be helpful not only to encourage the citizenry to pay tax but also minimize (or eliminate) corrupt activities from officials.

Implement prudent expenditure measures: Reforms in policy making will not be complete without looking at the expenditure side. There is the need for prudent austerity measures to be implemented to deal with budget deficits. For instance, there should be significant cut in unproductive expenditures; the size of government should be reduced significantly (possibly to between 40 and 50 ministers); and the need for a continuous audit of the payroll.

Eliminate political pride and propaganda regards going to the IMF: While it may be argued that assistance from multilateral institutions such as The World Bank and IMF, may not be long term solutions, they have proven to be very helpful in the short to medium term. Unfortunately, going to the IMF for assistance has been politicized in Ghana, and the political propaganda has made seeking such assistance a sign of weakness or irresponsibility on the part of the government or managers of the economy. As earlier indicated, the SDR interest rate is about half of (or lower) what is offered on ICM. The government and other stakeholders should, therefore, change this unhealthy narrative, burry their pride, and initiate talks at various levels of regional economic community meetings (such as ECOWAS and AU) to push for reforms that will make such cheaper sources of funds more accessible to developing economies.

Reference

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