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BUDGETARY INSTITUTIONS AND FISCAL CONSOLIDATION IN GHANA: LESSONS FOR TRANSITION ECONOMIES IN AFRICA

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ABSTRACT

To halt the deterioration of their national economy most African governments embarked on IMF and World Bank supported Structural Adjustment Programmes. These programmes have been criticised as neglecting social costs and promoting export-led growth in the context of unfavourable terms of trade. More recently, their lack of attention to institutional development has been emphasised. This paper focused on the budgetary institutions and procedures during structural adjustment in Ghana. The paper concludes that budgetary institutions are more hierarchical in Ghana. However, the hierarchical process had a minimal impact on fiscal consolidation for a number of reasons. The reasons include increased expenditure during consolidation, difficulty of dealing with losers after initial success, tendency to allow donor support to lead government spending and the lack of institutional capacity to assess overall impact of fiscal procedures on consolidation effort. While drawing the attention of countries with similar structural difficulties to these lessons, the paper concludes that fiscal policy will produce positive impact when budgetary institutions, procedures and outcomes are designed to influence other institutions in support of increased productivity.

I INTRODUCTION

The collapse of Sub-Saharan Africa's (SSA) economies has many causes, including the failure of state-led development strategies (or at least the form that they took) and adverse commodity price shocks. By the early 1980s, the productive sector was depressed in many countries, and physical and social infrastructure was deteriorating rapidly. With the erosion of living standards, human capital declined, thereby eroding the basis of production and productivity.

As an immediate response to their economic crises most African countries implemented International Monetary Fund (IMF) and World Bank supported structural adjustment programmes in the 1980s[1]. Adjustment is intended to reduce the current account deficit to a level that can be sustainably financed (by long-term capital inflow), to reduce inflation, and to restore per capita income growth. Fiscal policy plays a central role in this; a reduction of the fiscal deficit reduces money supply growth and therefore inflation (under the IMF's Polak model) as well as crowding out of private investment.

Needless to say, adjustment programmes have been very controversial. Early criticism focused on their social costs[2] and their attempt to promote export-led development in the context of unfavourable terms of trade for Africa's primary commodities. These criticisms still stand, in particular the need for Africa to diversify its export base. More recently, the lack of attention to institutional development in adjustment programmes has been emphasised. Market economies do not arise in an institutional vacuum, and the market needs the partnership of an effective developmental state. The task facing policy makers therefore amounts to much more than market liberalisation. The term 'transition', which embraces the need for institutional investment to support a market economy, is probably a better description of the processes than the more conventional term, structural adjustment (Addison, 1998).

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[1] It is important to note that socialist ideology was abandoned as part of these adjustment programmes not only in Ghana but also in Guinea, Mozambique and Tanzania (Sahn, Dorosh and Younger, 1997).
[2] Through the instrumentality of UNICEF Ghana introduced the Programme of Action to Mitigate the Social Cost of Adjustment (PAMSCAD) in 1987 as a short-term palliative on the way to full economic recovery (Hutchful, 1994; Loxley, 1988).

Ghana was one of the earliest adjusting countries, starting in 1983. By the early 1990s Ghana was the showpiece of the Bretton Wood Institutions (BWIs); successive structural adjustment programmes had been consistently implemented (Sahn, Dorosh and Younger, 1997). The reduction of the fiscal deficit and obtaining greater efficiency in the use of resources was at the centre of the Ghana programmes[3]. In addition, World Bank sector programmes aimed to improve policy and public spending in the areas of agriculture, manufacturing, energy and human resource development.

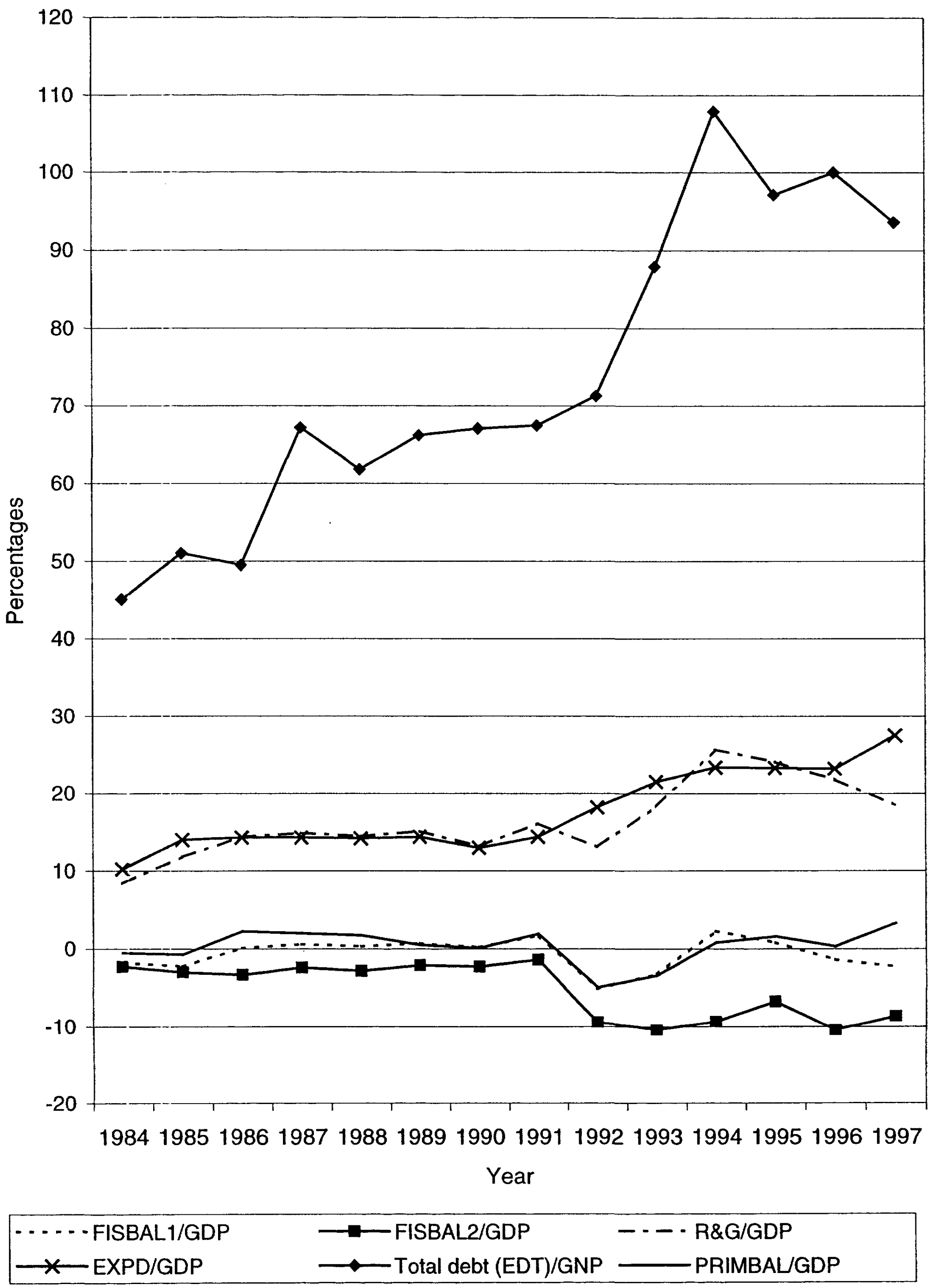
At first sight, these policy changes and their outcomes were impressive. But, as Ghana made progress with democratisation we have witnessed political cycles in fiscal performance. In 1992, a huge budget deficit re-emerged. Similarly, in 1996 a substantial fiscal deficit was recorded; these were attributed to the election year expenditure boom. In fact those who favour very restrictive fiscal deficit targets argue that fiscal consolidation did not take place at all because over the years the broad budget[4] balance was consistently in the red. The total debt-GNP ratio also climbed steadily (see figure 1 and Appendix Table 1).

The measures implemented to reform public services and public sector employment were part of a parallel effort to support the stabilisation programme. Redeployment of labour in the civil service, reform of civil service salaries and wages, divestiture and privatisation of state owned enterprises (SOEs), emphasis on value for money in the formulation of public investment programmes (PIPs) and the medium term perspective on government expenditures contributed to the economy's revival.

[3] For the advanced democracies, efficiency meant halting the growth of the public sector and also the introduction of deregulation, privatisation and marketing (Lane, 1997). In developing countries, where public spending on infrastructure development is considered a precursor for private sector growth, halting public sector growth does not appear immediately feasible. Another important dimension of the efficiency drive is the elimination of corruption (see World Bank, 1997; Mbaku, 1994).

[4] The Government of Ghana until 1995 had distinguished between a narrow and broad budget definition. The narrow coverage (FISBAL1 in figure 1), which is the operational budget, includes the Government's expenditure and revenue but excludes projects financed through external aid (grants) and loans. It is frequently argued that the primary deficit (which excludes such items as debt service and interest payments) reflects a country's fiscal stance. But in the case of Ghana, with a stable government over a long period of time, the overall fiscal balance is probably the best yardstick for judging fiscal performance.

Figure 1: Fiscal Performance Indicators
(Percent of GDP): 1984-1997



This paper discusses the main features of Ghana's recent adjustment efforts, assesses the impact on fiscal consolidation, and draw lessons for countries with similar structural difficulties. The paper has two objectives. First, to review Ghana's effort at fiscal consolidation during the adjustment era in the light of institutional and procedural constraints. Second, to draw out comparisons with other African countries where relevant.

Section II discusses the analytical framework. Section III focuses on prioritisation, institutions and budget procedures during the period of adjustment with particular emphasis on stages in the budget cycle, legislative and constitutional framework, sectoral budgets and donor influence. Section IV briefly assesses the foregoing for fiscal consolidation. Lessons for other countries with similar structural forms are discussed in section V. A number of terms are explained in the Appendix.

II THE ANALYTICAL FRAMEWORK

A number of theories have influenced this paper. First, we emphasise that it is critical to understand the institutional environment and arrangements in which the formulation of budgets and the fiscal deficit target takes place. We adopt the tools of the positive theory of government behaviour and the new institutional economics (NIE) to help tackle the problem of the interaction between the allocation, distribution and stabilisation functions of fiscal policy[5]. The positive approach to budgetary process attempts to explain and predict budgetary decision (Kraan, 1996). NIE emphasises transaction costs in exchange and institutions as constraints on economic performance (North, 1995; Harriss, Hunter and Lewis, 1995).

While selecting this framework for our analysis we are conscious of some of the limitations of these theories in practice (Green and Shapiro, 1994; Premchand, 1993; Sappington, 1991). The literatures of political science and public administration have been critical of the positive theory of government behaviour and the NIE. Critics have attacked the relevant economic

[5] Allocation, distribution and stabilisation are the traditional functions of the state. Goode (1984) adds the following to the list - promotion of growth and development, equitable distribution of income and wealth, and national independence or self-reliance.

models, including the principal agent theory and the median voter model, and have described these as being based on a "narrow microeconomics paradigm", often involving simple-minded, self interested arguments (Kelly, 1998; Stiglitz, 1998). Some argue that the reform of the budget based on the above theories constitutes an attempt to substitute economic rationality for political rationality (Wildavsky, 1979; Kelly, 1998). Those in public administration also suggest that based on experience, theories framed in politics and economics are insufficient (Forrester and Adams, 1997). Whatever the basis of advocating the use of fiscal policy, however, there are certainly public choice explanations as to why governments will choose to borrow (Wagner, 1987).

But economic explanations of fiscal policy still have considerable strengths. The allocative function of fiscal policy is relevant when market failure causes private outcomes to be Pareto inefficient. Moreover, when market outcomes leave many in poverty (because of their lack of assets to start with), the government has an important distributional objective. Stabilisation by government is acceptable when market outcomes result in the under utilisation of the economy's resources (Musgrave, 1959).

While these issues have been derived and treated variously in the normative literature, a positive theory of government behaviour has emerged along side the normative treatment (see Musgrave, 1985). The positive theory was motivated by dissatisfaction with growing government spending, and set out to explain the motives behind this. It emphasised voting tendencies to increase public expenditure (through lobbying and log rolling) and of bureaucrats and politicians alike to maximise self-interest (Borcherding, 1977; Buchanan, 1975; Niskanen, 1971). It is in light of this positive theory of government behaviour and the insight provided by the NIE - about the interaction between the institutional environment and institutional arrangements[6]- that we review the budget institutions and budgetary strategies during Ghana's most recent (on-going) attempt at fiscal consolidation.

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[6] According to Davis and North (1971). The institutional environment is a set of fundamental political, social and political rules that establishes the basis for production, exchange and distribution. An institutional arrangement is an arrangement between economic units that governs the ways in which these units can co-operate and/or compete. (Quoted in Williamson, 1994.)

Microeconomic versus Macroeconomic Aspects of Fiscal Policy

The orthodox short-run macroeconomic prescription consists of fiscal restraint coupled with devaluation and a tight monetary policy. This is reflected in IMF on African adjustment programmes. The conditionalities target the reduction in the budget deficit, mainly through

(a) squeezing government spending, especially the reduction of the government wage bill and a freeze on employment;
(b) a series of currency devaluations, which in Ghana led to the depreciation of the cedi by over 1200[7] percent between 1983 and 1991; and
(c) high interest rates aimed at mopping up excess liquidity in the system.

These policies are usually successful in reducing the budget deficit in the short-run as happened in Ghana and Gambia (see Hadjimichael et al (1995), Kapur et al. (1991) in the case of Ghana and McNamara (1995) in the case of Gambia). But as observed by the World Bank (1988) "careless fiscal austerity can lead to prolonged recession, and can place disproportionately heavy burdens on the poor". Thus the report suggests that microeconomic aspect of public finance policy - how spending is allocated and revenue raised - matter as much as overall macroeconomic balance.

This argument is given extra force by the role of distributional conflict in fostering macroeconomic instability, a relationship that has been identified as relevant in the growth literature (Person and Tabelin, 1994). While IMF conditionality focused on fiscal restraint, and the overall level of public spending, it gave insufficient attention to budget processes. These came as an after thought in the recent economic reform processes (Williamson, 1994). But there are a number of complications that arise when budgetary institutions come into the analysis. In the case of the Gambia, McNamara (1995) remarks "Ironically the government's success in reducing the deficit probably made more fundamental reform of the budget system more difficult". Such detailed reforms entail managing resistance from losers (individuals and institutions). The ability to balance the interest of losers and gainers is the most difficult when fundamental reforms are tackled. Losers scream louder and invest more in frustrating reforms (Stiglitz, 1998; Kanbur, 1994; Kahnenmann and Tversky, 1991).

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[7] This computation is based on "end of period" figures. The percentage decline in the cedi is approximately 3,900 using "period averages" for the same duration.

In the case of Ghana the election year expenditure boom, which characterised the 1992 fiscal year, made the institutional question more relevant. Government, concerned with a "continuity agenda", raised public sector wages significantly, embarked on "vote winning projects" across the country and reduced its tax effort. As a result, spending limits were exceeded (Sahn, Dorosh and Younger, 1997). During this time government revenue was also limited by a considerable reduction in the availability of foreign grants. Donors adopted a "wait and see" attitude to the transition to multi-party democracy. Viewed through the lens of losers resisting reforms, there are several issues that made budget reforms a particularly difficult choice (see McNamara, 1995). These are as follows:

(a) It would take power from bureaucrats at the Ministry of Finance, thereby reducing their income from graft (see McNamara, 1995). It is now a common hypothesis that the private interests of bureaucrats drive them to maximise[8] the budgets of their bureaux (Niskanen, 1971).
(b) Affect the power of the cabinet to allocate extra budgetary expenditure. With the emphasis on value for money and financial management dominating budgetary reform, it is less easy for government to use unbridled supplementary budgets to allocate resources to selected sectors.
(c) Reduce the spread of public spending[9] by linking recurrent to development expenditure[10]. This process makes it less easy to take on numerous "political projects."
(d) Furthermore, increased transparency made it less likely for implicit subsidies and other inefficiencies to remain hidden.

But a political authority must always assume responsibility for the budget. This role cannot be wished away (Caiden and Wildavsky, 1990; Goode, 1984 pp. 39). All these call for institutional analysis.

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[8] Shibata and Shibata (1997) have, however, demonstrated that the utility maximising motive is compatible with budget minimisation. They use the case of Japan.

[9] Spreading public spending is one of the politicians' escape routes. It is politically expedient to do something about everything (Uphoff, 1970). Wallich and Alder (1951) noted that when budget spreading is combined with balanced budget financial responsibility, the result is irresponsible leadership characterised by "lack of conscious attempt to use the fiscal system to pursue specific economic objectives...." Quoted in Caiden and Wildavsky (1990).

Allocative and Distributive Efficiency and the Size of Public Spending

Rowley (1987) concludes that, excepting Malthus, the classical economists detested debt financed public expenditure and public deficits. Aside from the efficiency argument, they feared big government, which they saw as a threat to liberty. This classical view permeates World Bank and IMF advice. Countries with low capabilities are advised to concentrate on the minimal functions of the state - providing pure public goods and protecting the poor (World Bank, 1997). Minimal functions include the following:

- Establishing the foundation of Law (Defence, Law and order, Property rights)
- Investing in basic social infrastructure such as public health (sanitation programmes, provision of portable water, reproductive health programmes, etc.)
- Macroeconomic management (maintaining a non-distortionary policy environment, revenue mobilisation, allocation of public spending, decentralisation of public functions etc.)
- Anti-poverty programmes (family planning and population control, adult literacy programmes, targeted assistance, disaster relief).

In fact, the above agenda requires substantial government spending. Increasingly, poor countries are also engaged in what the World Bank (1997) describes as the intermediate functions of the state - addressing externalities, regulating monopoly, overcoming imperfect information and providing social insurance. This is the result of an international demonstration effect (and/or globalisation). Taking care of these other functions helps to stimulate private investment and an inflow of foreign investment. Thus governments can very often justify big spending programmes. Most of the time the bulk of this spending consists of recurrent type expenditures. Consequently, Government Revenue excluding grants is almost exclusively used to finance recurrent expenditures in poor countries (see Figure 2).

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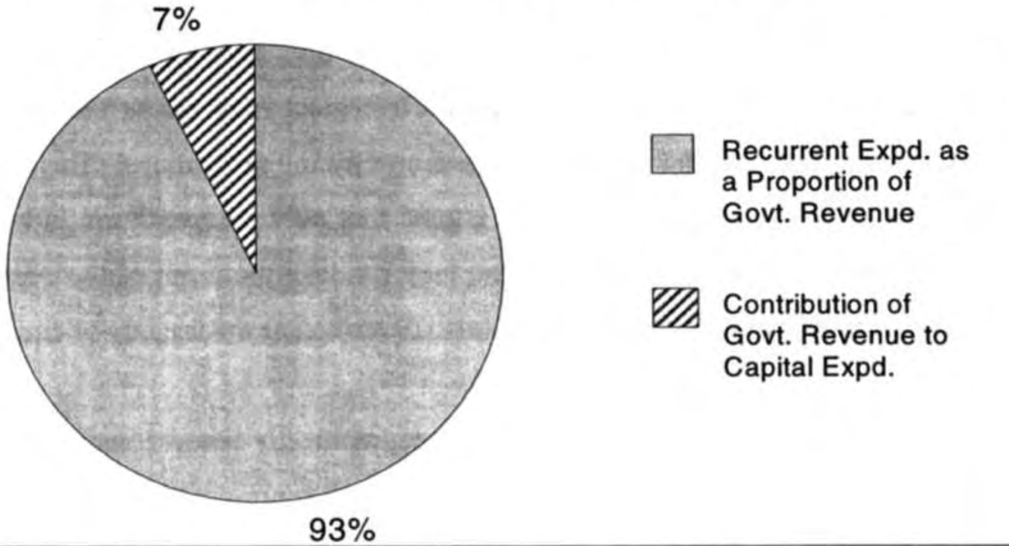
[10] Ghana is now preparing to launch a Medium Term Expenditure Framework to integrate the Public Investment Programme (PIP) and the recurrent expenditure programmes into a unified three-year rolling programme in the 1999 financial year.

Figure 2: Average Distribution of Government Revenue between Recurrent and Capital Expenditure: 1989-1996



Contemporary discussions in economics and political science present a body of theories, which are used to explain the growth of government spending and the budget deficit in the advanced economies. Lane (1995) classified these as demand-side and supply-side policies. Wildavsky (1987) also suggests that value and belief systems of nations could affect the size of government expenditure. On the demand side economists frequently make reference to Wagner's Law of Expanding State Activity. This law is interpreted as predicting growth in the ratio of public spending to national income as a consequence of increases in per capita income resulting from industrialisation (Goode, 1984 pp. 53). With industrialisation the administrative and regulation functions of government increase in scope. The evidence from the 1960s and 1970s shows that it is highly possible for government expenditure, in developing countries like Ghana, to continue to grow at a faster rate than the national income (Goode, 1984). The functions of governments in developing countries enumerated by Goode show that developing countries have a large scope for public sector activity (see footnote 5). Public expenditures and fiscal consolidation can also be viewed through the lens of a supply[11] side logic of interests. The main argument here is that rent-seekers (interest groups) supported by government departments and government-dependent private contractors create

[11] Supply in this context consists of the inaction of unorganised losers in the net transfers to organised rent-seekers, who constitute the demand side in the transfer brokering mechanism (Rowley et al., 1987).

an imbalance in the budget towards deficits (Rowley and Tollison, 1986; Rowley, Shughart II and Tollison, 1987).

To conclude, we want too draw attention to the phenomenon whereby fiscal policy has been biased toward fiscal deficit with primary concern for monetary outcomes and inflation and thus neglecting other legitimate functions. Such neglect may create the condition for an unnecessary expansion of the spending programme by interest groups. Beginning with the common resource pool problem it can be argued that public expenditure is bound to grow because different interest groups believe that they can take more out of the central pool than they will be expected to contribute in taxes (also described as the tragedy of commons).

It has been demonstrated that politicians with geographically based constituencies (a feature of Ghanaian politics even in the absence of elected representatives) do not completely internalise the cost of financing "pork barrel" projects (Weingast, Shepsle and Johnson, 1981). Velasco (1995) argues that spending ministries will prefer an increased allocation to their sector, which draws on a common pool of tax revenue for the same reason. Rent seeking by interest groups worsens the overall budget balance through tax exemption clauses and other privileges which depress Government revenues. In recent times the Private Enterprise Foundation (PEF) is one group actively engaged in lobbying Government for tax exemptions and improved business environment[12]. At the other end of the scale, special government spending resulting from rent-seeking activities of interest groups will, if not compensated by expenditure cuts elsewhere, increase overall government spending. Ad hoc spending on such programmes as poverty reduction (PAMSCAD, Non-formal Education etc.) and the creation of special bureaux (e.g. the Business Assistance Funds) and task forces have resulted in less than efficient and effective resource use, while pursuing the objective of consolidation.

That there exists a direct relationship between rent seeking by interest groups and a worsening of the budget deficit can be seen by looking at budgetary institutions and processes. Essentially we shall be concerned with the accuracy of signal transmission between interest groups and political and/or central budgetary authorities through the

[12] The emergence of Business Associations such as Ghana's PEF with considerable leverage, supported by donors as a lobby for private sector development, is a new phenomenon in developing economies (Lucas, 1997).

bureaucracy, ministries, departments and agencies (MDAs) and Parliament. The institutional environment and institutional arrangements of the MDAs influence the amount and quality of information that eventually reaches the central budgetary authority, Ministry of Finance and Economic Planning (MFEP) and the cabinet. Empirical evidence suggests that there is often an information asymmetry between the central budgetary authorities and the MDAs. This causes inconsistency in budgetary allocations, which adversely affects the objectives of stabilisation, economy, efficiency and effectiveness. The degree of information asymmetry and the distortion of budgetary objectives (particularly the stabilisation objective) will depend on whether the institutions and processes[13] are "hierarchical" or "collegial" (Perotti, 1997; Alesina, Hausmann, Hommes and Stein, 1996; Alesina and Perotti, 1996). The impact of procedures on budget size is reviewed in the context of the government's power of initiative and agenda setting, and different patterns of lobbying and vote cycling within cabinet and parliament (Perotti, 1998). Hierarchical procedures concentrate budgetary decisions at one point, usually the treasury. On the other hand collegial procedures provide for greater input from all agents in the budgetary process (Alesina Hausmann, Hommes and Stein, 1996; Stein, Talvi and Grisanti, 1998). The evidence shows that hierarchical arrangements are more supportive of the stabilisation goal[14](Alesina and Perotti, 1995). Thus agency theory and transactions costs theory have been seized upon as handy tools to characterise the relationship between the budget controller (ministry of finance and treasure) and ministries, departments and agencies (MDAs).

Understanding these interactions and rearranging them is probably the key to forecasting the sustainability of fiscal deficits as well as the success of any exercise in fiscal consolidation. There is evidence to this effect from the experience of the European Community (von Hagen, 1992; von Hagen and Harden, 1994), the American States (Poterba, 1994; Alt and Lowry, 1994; Bayoumi and Eichengreen, 1995) and Latin America (Alesina Hausmann, Hommes and Stein, 1996). Perhaps the only handicap is that this study covers a period when attempts to change institutions are implicit in the fiscal consolidation.

[13] Associated with these arguments is the theory of "fiscal illusion" and strategic ambiguity in voting behaviour that explains the tendency of politicians to adopt less transparent policies in general (and budgets in particular). An ill-defined institutional framework may also creates room for transparent accounting (see Alesina and Perotti, 1996; Kenneth Rogoff, 1990).

[14] Despite this observation, it has been pointed out elsewhere that corruption is often embedded in the hierarchical structure of the bureaucracy (UNDP, 1997). Evidently, the more hierarchical, the greater the embedded corruption, which affects efficiency but may also affect size of spending significantly.

III PRIORITISATION, INSTITUTIONS AND THE BUDGET PROCEDURE IN GHANA

Budgetary strategy reflects changes in the size of spending, major allocations of resources, the nature of the tax system and the size of the deficit. Budgetary proposals are the translation of the budgetary strategy of the executive. As such they are fundamental policy documents. It is true that the manner in which budgeting is conducted affects the balance between mobilisation of claims and the rationing of resources, hence the importance of procedures (Schick, 1990 pp. 223; Perotti, 1998). This section reviews government priorities as revealed in the budget and other policy documents and shows how budgetary institutions and procedures affect these priorities and budget outcomes[15].

The main policy documents reviewed for the purpose of this section include: government budget statements, presentations to the consultative group meetings on Ghana, UNDP development and co-operation reports, and World Bank ESW papers on Ghana. The review shows that government priorities regarding development projects have two dimensions (a) the efficient use of public resources and (b) the identification of so called key sectors. Government acknowledged the scarcity of resources and sought to rationalise and streamline the allocation of development funds with a view to maximising the efficient application of funds. Consequently, the government outlined the following criteria for the allocation of funds, adding that projects admitted into the development budget will be subjected to strict expenditure controls (Government of Ghana, 1990[16]).

(a) government priority programme for the medium term;
(b) on-going donor assisted projects or wholly government of Ghana projects programmed for completion during 1990;
(c) on-going donor assisted projects to be completed after 1990;
(d) on-going projects wholly financed by the government of Ghana, to be completed after 1990;

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[15] In the language of NIE, we are concerned with the impact of institutional environment and institutional arrangements on the revealed priorities.
[16] The ordering which follows was not applied only in 1990. It has been applied throughout the period of the on-going reforms.

(e) new donor assisted projects; and

(f) new government of Ghana wholly funded projects.

Key sectors consistently identified and mentioned in the various budget statements as well as other documents reviewed and the targeted objectives are summarised in Table 1. We shall take up the issue of institutions and procedures on the revealed priorities and fiscal consolidation in the next section.

Stages in the Budget Cycle

Ghana typically combines the object of expenditure and incremental budgeting techniques in the budget process (Dordunoo, 1996; Premchand, 1993). Programme and Performance Budgeting (PPB) and priority listing of projects are some of the recent practices (Premchand, 1993). See Appendix 1 for the definition of the various approaches to budgeting. The object of the expenditure approach is to impart political and legal control to public spending (Goode, 1994 pp. 14). Under this system of budgeting, line item details obscure programme implications and makes it easy to constrain spending without much opposition (Schick, 1990 pp. 31). As part of the incremental approach to budgeting previous commitments have strong or at least weak influence on current and new commitments. While previous commitments become an added constraint on prioritisation under incremental budgeting, an atmosphere is created that spurs both spending ministries and the finance ministry to be optimistic about growth in the budget.

The PPB techniques emphasise output rather than input. Programmes are judged by output and not input appropriation. Hence the use of cost-effectiveness techniques to evaluate each budget item. Analyses are more systematic, covering the spending base as well as any increment. The PPB may be characterised by wasteful lock up of resources. All projects are reviewed at the beginning of each budget year. And if the appropriation to an on-going project is deemed to exceed expected benefits, the project is suspended. Thus numerous projects were suspended and new ones initiated only to be abandoned at a future date, and the cycle continues.

Table 1: A Matrix of Government Priorities by Sector

SECTOR	AGENDA	HIGHLIGHTS
Economic Services Agriculture Lands & Forestry Mines & Energy Trade & Industry Tourism Roads & Highways Environment Science & Technology Transport & Communication	• Rehabilitation and development of additional economic infrastructure to provide support for private sector activity • Increase policy formulation and implementation capacities of MDAs	• Logistic & training support for MDAs • Establishment of Policy Planning Monitoring & Evaluation Divisions in all ministries • Recruitment of senior level staff • National electrification and promotion of Liquefied Petroleum Gas • Rehabilitation and expansion of the telecommunication network • Agricultural rehabilitation credit for peasant farmers • Divestiture of state owned enterprises • Construction of feeder roads • Rehabilitation and maintenance of trunk roads.
Community & Social Services Works & Housing Education Youth and Sports Health Labour & Social Welfare Information	• Rehabilitation and improvement of social infrastructure and delivery systems.	• Reform of basic education and introduction of cost sharing in tertiary education • Emphasis on primary health care and introduction of cash and carry in drugs. • Provision of large scale rural water supply and low cost sanitation projects • Supplementary feeding programmes • Providing incentives to private estate developers • Improved local building materials project • Enhancing opportunities for women in development • Non-Formal education.

Table 1: cont'd

SECTOR	AGENDA	HIGHLIGHTS
General Services Interior Defence Legal Services Office of National Security Office of the President Foreign Service Office of the Head of Civil Service Public Services Commission Commissions and Councils Statutory Organisations Regional Organisations	• Restructure and upgrade of the Public Administration System • Increase the effectiveness and output of the public administration system • Model the public administration system to provide an enabling environment for private sector development.	• Civil Service reforms • Establishment of the National Development Planning Commission • Redeployment in the public service • Reform of Ghana Investment Centre and Investment Code • Continuous revision of all legislative and administrative practices which affect commercial and industrial activities
Lower levels of Government Local Government	• Democratisation, decentralisation and devolution of government.	• Establishment of District Assemblies • Establishment of unit committees and regional co-ordinating councils. • Establishment of district assemblies common fund • Creation of decentralised departments

Given the budgetary techniques, any budgeting should cover decisions regarding fund generation, bidding of budgetary funds and allocation; Schick (1990) calls them the irreducible elements of budgeting systems. These are covered in critical stages in the budget cycle identified in the Table 2. The Table summarises the stages in the budget cycle as a series of principal-agent relationships from politicians to senior bureaucrats to subordinate bureaucrats.

Table 2: Stages in the Budget Cycle

Stage/Activity	Objective(s)	Principal(s)	Agent(s)
1. Preparation of macroeconomic models and defining links between the macroeconomic parameters and the budget	Definition of overall policy needs for stabilisation, growth and other objectives which influence the level and composition of government expenditure and revenue	Executive/Minister of Finance	Bureaucrats at the Ministry of Finance
2. Issue of Budget Circular	To collate inputs from Ministries, Departments and Agencies [a)]	Minister of Finance/Bureaucrats in the Ministry of Finance	Sector Ministers/ Heads of Departments and Agencies.
3. Preparation of Inputs	To provide financial estimates of expected revenue and cost of programmes, projects and operational activities	Sector Ministers/ Heads of Departments and Agencies	Bureaucrats in the operational and field units.
4. Examination and compilation of returns	To aggregate sectoral submissions, examine linkages and reconcile revenue estimates with expenditure estimates	Head of Budget Division, Ministry of Finance.	Bureaucrats at the Budget Division.
5. Preliminary budget hearing [b)]	To discuss plausible limitations on submission with heads and finance/ administrative heads from the sector ministries	Bureaucrats at the budget division of Ministry of Finance.	Heads and finance/ administrative heads from MDAs.
6. Director of Budget's Memo or Recommendations	To appraise the Minister of Finance on the size of the budget and its policy implications	Minister of Finance	Director of Budget/ Bureaucrats in the Budget Division of Ministry of Finance.
7. Budget Hearing by Minister of Finance	To enable sector ministers to intervene on sectoral proposals deleted and the approved allocation to their MDAs[c)]	Minister of Finance/ Bureaucrats in the Budget Division	Sector Ministers supported by their Chief Directors.
8. Submission of estimates to cabinet	To seek the political approval of the budget.	President and Cabinet	Minister of Finance

Table 2 cont'd

Stage/Activity	Objective(s)	Principal(s)	Agent(s)
9. Submission to Parliament [d)]	To seek the approval and enactment of the budget by Parliament,	President and Cabinet/Minister of Finance	House Public Accounts and Select Committees and the entire membership of Parliament
10. Negotiations with the IMF, World Bank	To reach a consensus on credit ceilings and budget profile	Republic of Ghana	Minster of Finance/ Bureaucrats at the Ministry of Finance/ Officials at the Central Bank/Teams of Economic and Financial Consultants
11. Consolidation, printing and publication of documents	To disseminate information of public finances to the public [e)]	Ministry of Finance	Public relations division of the Ministry of Finance/ Ministry of Information.
12. Execution and Implementation	Carrying out the activity of revenue collection and spending on approved programmes, projects and operational activities	Minister of Finance	Controller and Accountant General's Department and heads of MDAs
13. Accounting and Auditing	To produce the financial data for review and reconciliation of public finances. Also to ensure that public funs are not misapplied.	Minister of Finance/ Controller & Accountant General/ Auditor General/ Heads of MDAs	Staff of Controller and Accountant General's Department/ staff of Auditor General's Department/ field and operational staff of MDAs
14. Public Expenditure Review	Evaluate the budget in order to improve the overall budgeting and the budgetary process	Government of Ghana	Until 1993 - World Bank/ Bureaucrats of the Ministry at the Finance

Notes: a) The circular detailing the guidelines for the preparation of annual estimates goes to all MDAs. Another circular goes to all revenue collecting agencies calling for revenue estimates and other receipts for the coming year. Although a circular goes to all non-revenue collection public sector to detail their projected incomes and fees, admittedly they do not comply (see Dordunoo, 1996); b) A report collated by an IMF team led by A. Premchand in 1990 skipped this step. But Dordunoo (1996) who had served as an in house consultant to the Budget Division of the Ministry of Finance made reference to this activity in Dordunoo (1996). My personal knowledge of the system suggests that this is a relevant and a significant activity; c) Dordunoo (1996) argued that while some sector representatives discount budget hearings as mere rituals to formalise figures informally agreed upon, much provision are made on the basis of hearings. He observed further that budget hearings offer an excellent opportunity to test heads of MDAs on their administrative and financial responsibility as well as their knowledge of the mandate and operations of the agencies under them; d) This step was not part of the process before 7 January 1993; e) The documentation is out after approximately one year and the distribution is limited. It is only distributed to sectors for the records. One is fortunate to find them in the sector libraries.

The Legislative and Constitutional Framework

A close observation of the stages in the cycle suggests that the budgetary process in Ghana is, to a large extent, hierarchical. Authority is very much vested in the Minister of Finance and Budget Division of the Finance Ministry. This authority is derived from the legislative and constitutional framework for the preparation of the budget. Although the relevant instruments are not consolidated, prior to the arrival of the fourth republican constitution, we identify the Financial Administration Decree, 1979, SMCD 221 (FAD). The accompanying regulation, the Financial Administration Regulations, 1979, L.I. 1236 (FAR), provides an exhaustive direction on budget preparation, implementation and evaluation (see section 25-90). FAR 25 provides that the Senior Principal Secretary (now Chief Director) of the Ministry of Finance shall be the chief authority responsible for the preparation, publication and control of the national budget, subject to the directions of the Government and the provisions of any other enactment.

Under the 1992 Constitution the main difference observed in the cycle is the role of Parliament. By the constitution Ghana is committed to the decentralisation of the public sector and strong local governments, which require a composite budget framework. However, the centre is yet to let go of things. The initial cost of decentralisation is apparently the obstacle. Increased costs associated with providing resources for the effective functioning of the decentralised departments[17] and the new district assemblies is not consistent with the immediate objective of fiscal consolidation.

The Bargain for Sectoral Budgets

Stages in the budget cycle suggest that the bargaining over sectoral allocations of resources can be a complex game. The FAR requires that the Senior Principal Secretary of Ministry of Finance issue budget guidelines to all Heads of MDAs indicating:

(a) selected policy options of the government for the preparation of the annual budget (i.e. the macroeconomic framework and targets);

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[17] Antonio Estache and Sarbajit Sinha (1994) have demonstrated that decentralisation can significantly increase government expenditure when subnational governments rank infrastructure as a higher priority than do the national government. Ter-Minassian (1997) also discusses the difficulties in implementing decentralisation and possible implications for stabilisation (see also Tanzi, 1996; Prod'home, 1994).

(b) structure of estimates to be submitted, supporting information required and subsidiary examination to be conducted by other agencies if proposals are to be routed through other agencies; and

(c) the dates by which estimates should be ready (see FAR 26 for details).

Given the guidelines there is a first stage of negotiations with the staff of the budget division. A second round of negotiations involves sector ministers and their bureaucrats and the finance minister and bureaucrats of the budget division. Depending on the political strength of a sector minister, there can be a third round of negotiation at the cabinet level. Lobbying in Parliament may also affect the level of appropriation in some sectors.

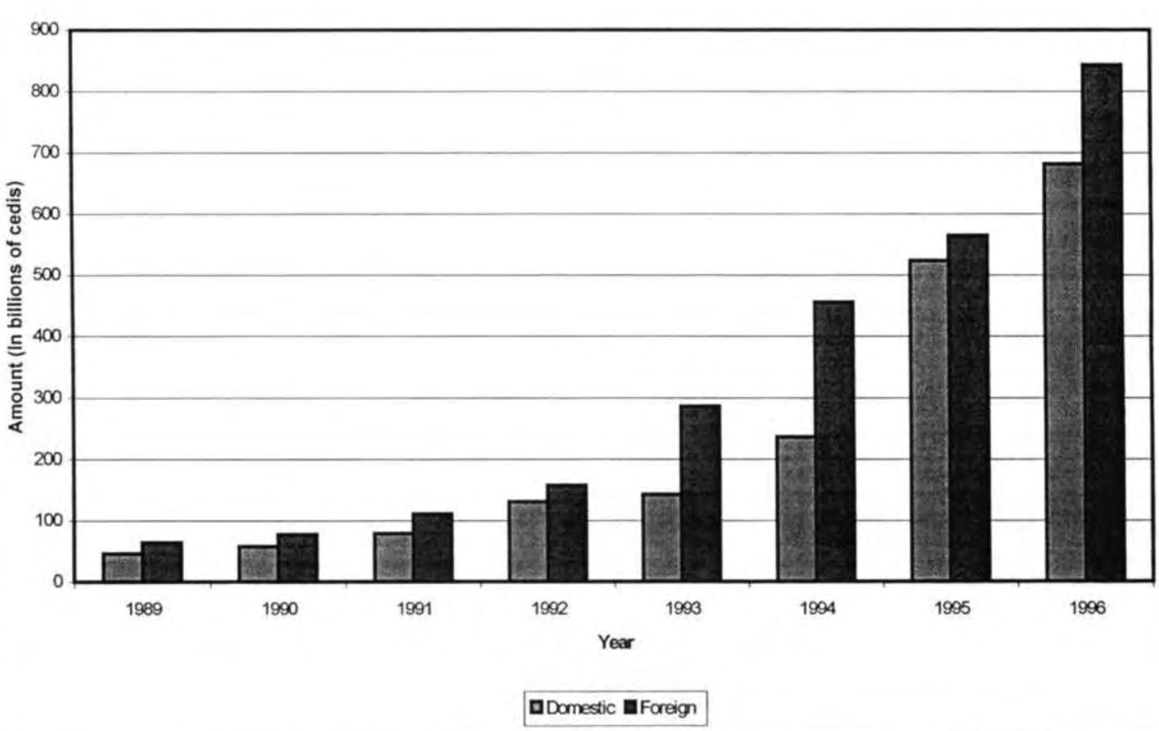
Up to a given level there exists the incentive for bureaucrats and politicians (sector ministers) to maximise the budget of their respective bureaux. Here public choice theory suggests that the motivation of self-interest will ensure co-operation between politicians and bureaucrats to pursue a larger allocation for their sectors. The "Public Expenditure Review 1994" identified the scramble by MDAs for resources to finance projects not informed by policy as the main problem in budget formulation. Naturally, beyond a given level the self-interest of the different categories of operators (from the field staff to the sector minister) will diverge. This is where we appeal to agency theory and transactions cost theory; conflicts between the agents and the asymmetry in the information at the disposal of the different groups produces waste in the planning and management of the public sector.

Donor Influence

While the budget cycle outlined above suggests that donor influence on budget institutions and procedures is limited to negotiations of credit ceilings and a budget profile with the IMF and World Bank, the extent of their involvement may be more extensive. Foreign grants remain a significant part of government revenue projections, rising from ¢44.9 billion in 1989 to ¢307.3 billion in 1996. The role of bilateral agencies in aid and grant disbursement is equally significant. Available information indicates that, as of 1995, 10 multilateral agencies, and 25 bilateral agencies contributed to the aid basket in Ghana. The number of Non-governmental organisations (NGOs) who had contributors to development assistance in the period is about 40 (GoG/UNDP, 1997). Furthermore, the volume of aid commitments and disbursement is approximately divided into equal halves between multilateral and bilateral donors (Government of Ghana, 1993, Annex Table 9). In the case of the capital budget, foreign financing has always outstripped domestic financing (see figure 3).

In the 1995 budget guidelines sought to internalise the magnitude of donor involvement in the development budget by moving away from the "narrow" budget framework. It argued that the narrow budget presentation consistently under estimated the amount of resources appropriated by the various sectors, making resource allocation and use less transparent (Ministry of Finance, 1994). At the time, familiarity of a sector minister and senior bureaucrats with the modus operandi of multilateral and bilateral donor institutions determined their ability to attract resources to the given sector. Invariably, the national budget is sometimes committed in the form of agreements to provide matching funds without the consent of Ministry of Finance. In Mozambique, Wuyts (1996) observed that "sectors

Figure 3: Total Capital Expenditure by Source of Financing: 1989-1996



which succeed in rallying strong medium-term donor commitments can better withstand pressure to cut its cash limits." Similar practices were reported for Kenya and Uganda (see Peterson, 1994; Whitworth 1996).

As a systematic search for foreign exchange was one of the aims of the government's reform program, one impact of donor influence was to motivate government to ration resources by the amount foreign resources attracted. When it was decided to produce estimates based on the "broad" budget framework the magnitude of resource allocation to sectors became clearer because MDAs have to disclose their financing plans. The plans indicate resources secured (both foreign and local) and the financing gap.

IV IMPLICATIONS OF INSTITUTIONAL AND PROCEDURAL ARRANGEMENTS FOR FISCAL CONSOLIDATION

The budget cycle as observed above shows that the budget process is largely hierarchical. The argument for a hierarchical budget is particularly strong for the period when Parliament was absent. Considerable authority was concentrated at the Ministry of Finance. Granted that the Minister of Finance had a recognisable leverage[18] in the cabinet his trademark was on the budget. During the era of parliament, the majority decision rule reinforced the hierarchical process. Hierarchical procedure induces fiscal consolidation but it has been demonstrated that majority voting rules and hierarchical procedures concentrate net benefits and induce "pork barrel" spending (Weingast, Shepsle and Johnson, 1981). Such tendencies can be observed in the behaviour of Ghanaian Legislators. Recently a group of legislator from one region collectively called the attention of Government to the state of roads in their constituencies. Arguably, they want the reward for their support to the government in the last two general elections. They argue, votes from their constituencies were and remain vital for the government's majority (Parliamentary Proceedings, 22 July 1998).

Another argument in support of the hierarchical process is the relatively conservative bureaucracy in which every individual is knowledgeable about the limits of his/her authority. Two possible explanations could be advanced for this posture. Firstly, the situation could describe the bureaucrats' perfect response to the intentions of the politician. From the politician's point of view it is important that the incentive structure of the bureaucrat should coincide with his/her intentions. The second explanation has to do with the bureaucratic behaviour of shirking; individual bureaucrats do not have the incentive to reveal the information available to them to others so as to hide their marginal inefficiency (Lane, 1995

[18] The long tenure of the Minister of Finance and the constant reference to a small Economic Management Team that handled all negotiations with the BWIs because of their own long standing relations with the BWIs suggest the Minister of Finance has the needed leverage in cabinet.

pp. 60). To overcome this problem, it was common practice to transfer directors from Ministry of Finance to Head MDAs in other sectors especially during crisis management to help obtain the necessary input, which guarantee fiscal discipline.

Furthermore, the reluctance of sectoral representatives to take advantage of the provision permitting them to intervene on their sectoral allocations strengthens the case for strong central budgetary authority. The foregoing conclusion that the budgetary process in Ghana could be characterised as hierarchical is not based on any rigorous statistical analysis. However, we are convinced that Ghana will score highly on the statistical index derived by Alesina, Hausmann, Hommes and Stein (1996) for Latin American Countries.

The empirical evidence suggests that hierarchical budgets produce budgetary savings and gains in fiscal consolidation, a minimum of which was observed during the era of adjustment. One question that needs further investigation is why despite the hierarchical budget process elections could induce such rapid expansion in expenditure? To ensure that the Provisional National Defence Council (PNDC) politicians win the 1992 election, budgetary outlay was significantly expanded. The increased expenditure was devoted to "pork barrel" projects aimed to wining votes particularly in the rural areas. New projects involving extension of the National Grid, major road construction, rural water supply etc. benefited from the 1992 and 1996 budgets. The Latin American experience show that electoral systems with large proportional representation may result in large government (government fragmentation) and large fiscal deficits. Ghana's electoral schedule is the simple 'first past the post' constituency system. It will be interesting to pursue further the relationship between this type of electoral system, delivery of "pork barrel" projects and size of the fiscal deficit.

The limited success in consolidation can also be explained by the government's inability to reduce expenditure during the reforms. Budgetary savings resulted from improvements in tax revenue collection (Younger, 1996; Sahn Dorosh and Younger, 1997). Government has argued time and again that expenditure reduction was not the best option for deficit reduction because the composition of its expenditure was such that any cut will adversely affect the health of the economy[19]. Limited areas where government admitted it could save on

[19] Despite this assertion, Public Expenditure Reviews and the Auditor General's reports consistently signalled inefficient use of resources as well as misapplication of resources (Ministry of Finance, 1994, 1995; also see Premchand et al., 1990).

expenditures include transfers to parastatal and subvented organisations and new initiatives on utility pricing (Government of Ghana, 1990).

Failure to reduce expenditures made improving the efficiency of expenditure more critical in the battle to reduce the budget deficit (Nashashibi et al, 1992 pp. 27). Here efforts were directed at raising capital outlays and also its effectiveness in the context of a three-year rolling public investment programme (Premchand et al., 1990). The ultimate objectives of the exercise was the rehabilitation of economic infrastructure and channelling more resources to operations and maintenance, particularly in the priority sectors of agriculture, health and education (Kapur et al., 1991 pp. 3)[20]. Having identified the policy objective as improving efficiency and quality of outlays rather than expenditure reduction, there was enough conviction that public expenditure (and even the budget deficit) will have to rise in the medium term (World Bank, 1993; ISSER, 1993; Nashashibi et al., 1992).

From the efficiency point of view, the civil service reforms happen to be one area where it was believed that much could be done about government expenditure. Reduction in the size of the service is to free resources, which could then be channelled into providing appropriate incentives, skills and motivation. Programme designers were convinced beyond doubt that improved condition of service, the right incentive framework, will induce efficiency (enhanced management and accountability) and commitment of the service to reform[21] (Lienert, 1998). This resulted in the redeployment of over 50,000 workers and widened pay differentials between the highest and lowest paid staff from 5.4: 1 in 1986 to 9.4: 1 by 1991 (Abed et al., 1998; Alderman, Canagarajah and Younger, 1995 pp. 262). It is believed that a substantial number of those redeployed have been re-engaged elsewhere in the public service. Significant new employment has also been acknowledged in the education sector and the local government sector. Consequently, estimates show that between 1986 and 1995 employment levels in central government services remained roughly unchanged. With employment at 331,579 in 1986 falling to 330,000; the annualised percentage is -0.05 (Abed et al., 1998; Merode, 1994).

[20] One of the main tasks of the Premchand report, cited in the preceding sentence, was to explore whether expenditure offer value for money and how to realise that objective (pp. 26).

[21] Civil service reforms were considered particularly important across the whole of Africa that between 1981 and 1991 fifty-five lending operations of the World Bank on the continent have components devoted to this course. Ghana had five of these loans/credits between April 1987 and May 1991(Nunberg, 1994).

The issue of pay-efficiency relations remains difficult. To what extent are current levels of pay enough to motivate civil servants and what levels of pay can the economy support? Abed et al. (1998) estimated the annualised change in real wages averaged 5.51 percent between 1986 and 1995. Thus wage bills as a percentage of GDP remain unchanged, an average of 5 percent during the period 1986 to 1995. This is well below the SSA average of above 6 percent and about 7 percent in CFA franc countries in West Africa (Lienert, 1998). It is clear that emphasis on short-term fiscal gain, minimising aggregate wage bill as percentage of government revenue, prevailed over institutional strengthening during the reform era. The disastrous consequences of failed labour market policies of the past - low morale, high absenteeism and moonlighting, difficulties of attracting and retaining skilled professionals, breakdown in supervision and discipline etc. (Lindauer and Nunberg, 1994) - are still prevalent a decade after the initiation of civil service reform (Girishankar and De Silva, 1998).

The other major component of the expenditure reform programme was to increase budgetary allocation to the operations and maintenance function. The two-fold objectives are to revive decaying infrastructure and ensure sufficient allocations for operating newly built economic infrastructure. It is difficult to find budgetary data on operations and maintenance to assist in any evaluation. However, it relatively easy to argue that weak budget monitoring and control and evaluation, which have resulted in significant spending overruns over the years least permits spending on maintenance and operations. The evidence is that loose monitoring and control also permit switching of expenditure. Under the circumstances when government pursues fiscal consolidation the capital budget is frequently cut along with the operating and maintenance budget (Abed et al., 1998; Sahn, Dorosh and Younger, 1997). Expenditure productivity is constrained and the long-term efficiency gain is sacrificed for the short-term stabilisation objective. Under ESAF II new budget and expenditure tracking and monitoring systems will be introduced. These will address the key issues of data availability pertaining to allocations, commitments and actual spending, financial reporting, monitoring and control, prompt processing of payments, arbitrary budgets cuts and feedback mechanisms and performance evaluation (Ministry of Finance, 1997).

A new public administration sensitive to private sector development and also pursue democratisation, decentralisation and devolution of government is also needed. To this end, improving efficiency, accountability and transparency in public finical management is the team of the Public Financial Management Reform Programme[22] (PUFMARP) under ESAF II in Ghana. As observed above, the budget documentation is not produced on time and effective distribution is only to MDAs for the records. As a result of limited circulation of the final budget document, appropriations remain close circuit information between Budget Officers at Ministry of Finance, Heads of MDAs, their accounting officers who are staff of the Controller and Accountant Generals Department, and the Controller and Accountant General's Department. Implementation and accounting/financial information is more obscured from public view and so are limited evaluation reports (PERs of Ministry of Finance and the Auditor General's Report).

The foregoing does not make for transparency. In the absence of public scrutiny creative accounting flourishes permitting fiscal profligacy to go on undetected for longer period (Kopits and Craig, 1998). It has been demonstrated elsewhere that transparency in budgeting and public finances correlates positively with fiscal discipline (von Hagen and Harden, 1994, Alesina, Hausmann, Hommes and Stein, 1996).

V LESSONS FOR TRANSITION ECONOMIES

Five main lessons can be deduced from this review of fiscal consolidation in Ghana. Firstly fiscal consolidation was pursued with increasing government spending. Thus Ghana relied on increased revenue to achieve fiscal consolidation. As shown in other places this has not worked (see Perotti, 1998). Secondly, initial success at deficit reduction can slow down when interest groups work to protect the erosion of rent accruing to them. Sustained consolidation always produces winners and losers. A carefully designed strategy is needed to overcome the resistance of losers during more substantive reform. Another lesson is that when substantial resources are provided by the donor community consolidation becomes more difficult. Here more government spending is induced through the provision of matching funds. In the extreme cases donor resources imply donor driven programmes which are not consistent with government policy intentions (see Ministry of Finance, 1995).

[22] This is a programme launched in July 1995 and officially initiated in May 1996 to tackle public

Furthermore the bid to attain fiscal consolidation without a total assessment of the fiscal institutions and their impact on the outcome of public sector management can at best result in temporary gains. Critical is the need to ensure that there exists the capacity to anticipate the various demands on government revenue and to produce value for money in the event of all public sector expenditure. This cannot be done without a total appraisal of the institutional environment and arrangements that guide the process. Finally we observe that representative democracy has the tendency to induce higher public spending. The type of electoral system adopted will influence the size of government and spending. It is therefore important to take a comprehensive look at the budgetary institution and process vis-à-vis the electoral institution; budgeting is not purely an economic process. It is an art that involve the use of the tools of politics, law, financial management and accounting as well as organisational learning.

In conclusion, fiscal policy has been mainly concerned with the target for the fiscal deficit to meet policy objectives for inflation and growth. The need to improve budgetary institutions has been relatively neglected. The positive impact of fiscal policy will emerge when budgetary institutions, procedures and outcomes are designed to influence other institutions in support of increased productivity. To meet ambitious expenditure programmes in developing countries we have to increase the efficiency of government expenditures and productivity.

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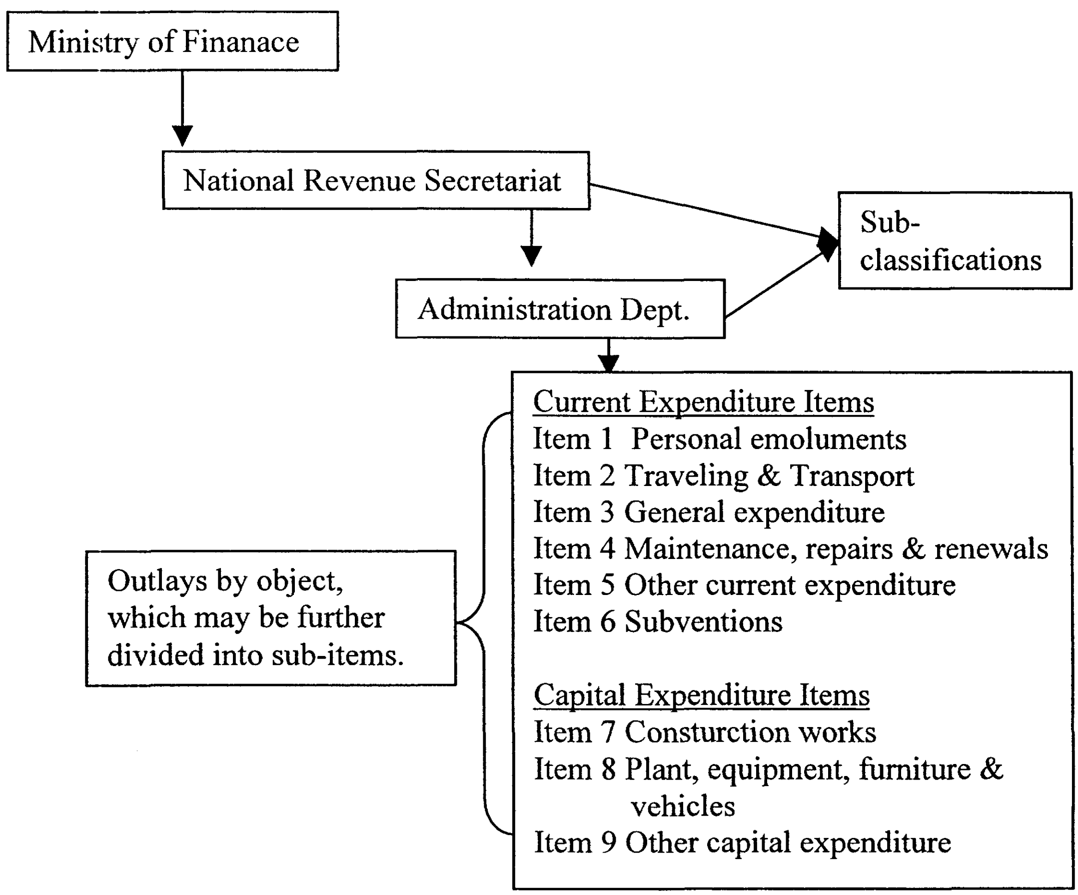
financial management issues raised in the Public Expenditure Reviews (PER) of 1993 and 1994.

APPENDIX: SOME TECHNICAL TERMS

Object of expenditure approach to budgeting takes the form of tabular classification of transactions by agency supplemented by object classification, which indicate items purchased. In Ghana for example, the budget classifies ministries with sub-classifications along functional activities. Outlays are then recorded by objects such as personal emoluments, travelling and transport, maintenance, repairs and renewals, etc. described as in Ghanaian budget parlance as Item 1 - Item 9 (see the figure below).

Example:



This mode of budget presentation permits easy monitoring of the legal function and public accountability functions of the budget. However, it is considered cumbersome, permitting very little management flexibility if any, less concerned with efficiency and may not provide the information needed for policy formulation.

Incremental budgeting is based on the premise that budget makers cannot and should not try to re-examine each budget item every year. It therefore takes the existing tax system and on-going programmes and projects as given. Consequently, budgeting is reduced to careful examination of small changes at the margin. These marginal changes in budgetary outlay could be positive or negative. It is very dependent on good working order. Its strengths include continuity and avoidance of unproductive conflict. The major disadvantage is the inability to exclude wasteful programmes early enough.

Programme and Performance Budgeting - This approach removes the emphasis on budgetary outlays in the form spending on inputs for specified objects and concentrate on output (measured in physical terms where possible). It relies mainly on cost-effectiveness criteria in selecting programmes to deliver an output. Medium to long-term projections and measurement of performance are essential parts of this technique. It has been argued that the expectations of programme and performance budgeting are over ambitious. Particularly, it might not always be possible to compare wide-ranging alternatives. Furthermore some outputs simply defy measure.

Zero-Base Budgeting - It calls for the re-examination of every single programme at the beginning of every budget. All spending are justified annually on the basis of output or performance as well as cost. The procedure emphasises managerial decision making relative to number-oriented budgets. A programme can discontinued if it turns out that mid-way in implementation the outcome can be judged as not consistent with the input required. The main criticism of this approach is that it is laborious.

Appendix Table 1: Fiscal Performance Indicators: 1984-1997

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Revenue & Grants/GDP	8.4	11.8	14.4	14.9	14.5	15.1	13.2	16.1	13.1	18.3	25.7	24.1	21.8	18.5
EXPD/GDP	10.2	14	14.3	14.3	14.2	14.4	13	14.4	18.2	21.5	23.4	23.3	23.2	27.5
PRIMBAL/GDP	-0.5	-0.7	2.3	2.0	1.7	0.5	0.1	1.9	-4.9	-3.4	0.8	1.6	0.3	3.3
FISBAL1/GDP	-1.8	-2.2	0.1	0.6	0.3	0.7	0.2	1.7	-5.1	-3.2	2.3	0.8	-1.4	-2.3
FISBAL2/GDP	-2.3	-3	-3.3	-2.4	-2.8	-2.1	-2.3	-1.4	-9.4	-10.4	-9.3	-6.7	-10.4	-8.6
Total debt (EDT)/GNP	45.1	51	49.5	67.2	61.8	66.2	67.1	67.5	71.3	87.9	107.9	97.1	100	93.6

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