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# **Ghana:** Letter of Intent and Technical Memorandum of Understanding

May 25, 2006

The following item is a Letter of Intent of the government of Ghana, which describes the policies that Ghana intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Ghana, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

May 25, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, DC 20431

Dear Mr. de Rato:

1. The recent implementation of sound macroeconomic and structural policies and the enhancement of business regulations, governance, and institutions over the last few years have led to a marked improvement in Ghana's economic performance. In a relatively short time frame, we have achieved nearly all of the objectives set out in Ghana's Poverty Reduction Strategy (GPRS-I) covering the period 2003–05, which was supported by the Fund's Poverty Reduction and Growth Facility (PRGF):

- The rate of real GDP growth has been raised and maintained at 5-6 percent per annum, resulting in significant gains in real per capita income and a measurable decline in the poverty rate;
- There has been a substantial decline in inflation since 2003, despite the liberalization of domestic petroleum product prices, and the recent spike in world oil prices;
- We have made substantial progress in enhancing public expenditure and financial management, and revenue administration, as well as increasing domestic resource mobilization. This, together with the enhanced growth, led to more than halving the ratio of domestic debt to GDP from the end-2002 level by end-2005;
- We have been able to increase markedly the country's gross international reserves—which now amount to more than three months of projected imports of goods and services—providing some cushion against shocks; and
- In the structural area, we have improved the operating and financial performance of state-owned enterprises, owing, in particular, to the emphasis on full-cost recovery pricing for commercially-oriented entities (including those in the petroleum sector).

2. Reflecting continued strong performance, our economic and financial program remained broadly on track during 2005. Budget execution was monitored carefully, and efforts to contain public expenditure were stepped up when a shortfall in tax revenue, grants and divestiture receipts became apparent. Nevertheless, a net shortfall (equivalent to about 1 percent of annual GDP) was registered in the first half of 2005. Consequently, the envisaged repayment of domestic debt in that period was not realized, and the ceiling on net domestic financing of government operations for end-June 2005 (a performance criterion) was exceeded (Table 1). The situation improved during the fourth quarter through the catching-up of external aid disbursements, a pickup in revenue collections, and further containment of nonpriority expenditure. However, despite ongoing administrative improvements—which included a sharpened focus on large corporate taxpayers and reform of procedures to avoid leakages through smuggling and under-invoicing of imports—there was a slight under-performance of tax revenue for the full year relative to program target.

Nonetheless, the programmed net repayment of domestic debt for the year as a whole was significantly larger than targeted.

3. Through vigilance, and accounting and technical progress in upgrading the computerized integrated personnel and payroll database (IPPD), the wage bill of the central government was held below the program targets in 2005. Our intention was to have completed the extension of IPPD to include all employees under the Ghana Universal Salary Structure (GUSS) and subvented agencies (police, universities, and research centers, etc.) by end-September 2005 (a structural performance criterion, Table 2). The government made its best effort to meet this timeframe, which, however, proved to be too ambitious. However, the integrated payroll databases for subvented agencies were established by end-December 2005. At this point, the GUSS payroll is fully computerized under the IPPD, and the coverage of subvented agencies has been completed. In the above exercise, we were cautious and took the extra time to ensure that both GUSS and subvented agencies payroll data are robust, free of duplication, and that their integrity—from the perspective of security—is assured.

4. During 2005, we made efforts to realize full cost recovery through the automatic pricing mechanism for petroleum products that was adopted in February 2005. However, two important developments frustrated these efforts. First, the strong and continuous rise in world oil prices rendered our quarterly adjustments inappropriate, as projected oil import prices in the mechanism turned out to be significantly below landed costs. This resulted in a cumulative loss for the Tema Oil Refinery (TOR) equivalent to 0.8 percent of GDP. Second, Nigeria—supplier of 70 percent of our crude oil imports—modified the payment arrangement from 90-day to 60-day credit period, which required a much larger working balance for TOR (equivalent to 0.6 percent of GDP). The combination of these two developments resulted in the ceiling on the stock of net domestic bank credit to TOR for December 2005 (a performance criterion) being exceeded. In response, we have decided on the following remedial measures: the pricing mechanism will be made more robust to fully take into account any deviation between the projected price and the actual landed cost in the preceding period; price adjustments have been shifted from a quarterly basis to a monthly basis beginning April 2006; and the government will verify and issue bonds to cover the accrued under recovery by TOR by September 2006.

5. We are confident that the program objectives for 2005—as elaborated in the Memorandum of Economic and Financial Policies (MEFP) attached to our letter to you of May 20, 2005—have been broadly achieved. On the basis of (i) the efforts to compensate for the shortfall in revenue during the first half of 2005, (ii) the remedial actions with respect to the payroll database for subvented agencies that ensured the achievement of our program objectives for 2005, and (iii) the remedial measures to bring the bank credit to TOR back in line with normal operations, we are requesting waivers for the nonobservance of the associated quantitative and structural performance criteria.

**Economic policies for 2006**

6. The focus of GPRS I was to establish macroeconomic stability, make some in-roads to reducing poverty by increasing spending in social areas (health and education), utilize public resources more efficiently, and strengthen economic governance. Taking account of the lessons, experience and outcomes during the past several years, we have now shifted the

focus of the strategy—now embodied in the Growth and Poverty Reduction Strategy (GPRS II), which covers the period 2006-09—to laying the foundation for accelerated growth. In this regard, we aim to consolidate macroeconomic stability—in particular, by reducing inflation further, creating an environment conducive to private-sector led growth (especially in agriculture), and developing our human capital. We have prepared preliminary costings of the GPRS II, which indicate an additional requirement of US$1.8 billion over the 2007-09 period. We have worked out a prioritization of programs in the GPRS II, which formed the basis for the Consultative Group meeting held in November 2005.

7. For 2006, our broad economic and financial program objectives include: real GDP growth of 6 percent, a lowering of inflation to single digits (about 8 percent by end-year), and a further accumulation of international reserves. To achieve these objectives, the fiscal stance will continue to lay the foundation for "crowding-in" private investment; and monetary and external policies will continue to focus on the inflation and international reserves targets. Also, continued effort to improve the composition of expenditure, enhance public financial management, strengthen the performance of public enterprises, and intensify civil service reform are expected to release resources that would be used to pursue the fight against poverty.

**Fiscal policy**

8. The 2006 budget approved by Parliament in December 2005 benefited from widespread consultation with stakeholders, and was informed by—and aligned with—the GPRS II. A key objective of the budget is to strengthen tax administration to make room for reduction in some tax rates that would lower the effective burden, and to increase the focus on productive and pro-poor expenditures. Accordingly, the emphasis is on measures to realize efficiency gains and to broaden the tax base so that policy measures to lower the marginal tax burden have minimum adverse impact on revenue.

9. Therefore, the 2006 budget targets a domestic primary surplus of 1.5 percent of GDP, consistent with a further reduction in the domestic debt-to-GDP ratio to 8.7 percent, which remains the government's fiscal anchor. The pace of domestic debt reduction is slower than in previous years, reflecting the relatively low level of the domestic debt stock, and the need to shift resources to other fiscal priorities. Nonetheless, we are aware of the need to maintain prudence, and to safeguard the fiscal stance against contingent liabilities stemming from the continuing rationalization of public enterprises and the civil service.

10. The budget envisages a slight decline in overall revenue to about 23½ percent of GDP. No new taxes were introduced as Ghana's tax burden is already relatively high, compared with historical experience and countries in the region. The government, however, is continuing with the rationalization of the tax structure, with a view to providing a strong base for the medium to long term. Accordingly, following the reduction of corporate tax rates in 2005, we have lowered the personal income tax burden. The personal income tax exemption threshold was raised and the rates for lower- to medium-income earners was lowered. Although these measures would result in some loss of revenue in the short term, we believe the long-run benefits of promoting growth would outweigh such costs. Another factor contributing to the decline in revenue in 2006 is the reduced dividends following the sale of profit making state-owned enterprises in the recent past.

11. Recurrent noninterest expenditure and public investment are being maintained at the same levels as last year. However, public investment will remain well below the level required to meet the Millennium Development Goals (MDGs). At the same time, poverty-related spending is budgeted to remain at the same program target for 2005, 8.3 percent of GDP, following the upward trend established since this administration's first year in office.

12. With regard to the wage bill of the central government, we continue to be concerned with the ability to attract and retain qualified personnel that can further our goal of bolstering service delivery and value for money. At the current level of remuneration, the civil service is losing highly productive employees, particularly in the health sector. While civil service wages have increased rapidly in recent years, they have done so from a very low base, and they continue to lose ground against those of the private sector. Nonetheless, the government is keenly cognizant of the resource constraint, and the fact that the wage bill is taking up a significant share of the domestic revenue effort. The broad policy of the government is to aim for wage increases in line with productivity gains. We have realized significant savings with the ongoing reforms in the civil service, including through the establishment of integrated payroll databases that reduced duplications. We intend to use these savings, together with regular adjustments, to better realign the salary structure and accommodate the monetization of some benefits to help stem the loss of qualified personnel. In this context, the increase in the government wage bill will be about 21 percent over the outturn for 2005, but the wage bill (including all allowances and bonus payments) relative to GDP will be maintained at the 2005 program target of 8.9 percent.

13. We welcome the additional resources from the Multilateral Debt Relief Initiative (MDRI), which will go some way toward meeting our resource requirements for the MDGs and which has made Ghana's external debt much more sustainable. Given that the modalities of the MDRI have now been established and are expected to be fully in place during 2006, we will present a supplementary budget to parliament no later than end-July. The government has assessed the resources released, and intend to use them to further enhance the realization of our development objectives—primarily through augmenting the current level of public investment and providing for key poverty sectors. These include the rehabilitation of essential major highways and feeder roads in the main agricultural areas. We shall be using the equivalent of US$125 million from the IMF relief in 2006, with the remainder in 2007 and 2008. The annual relief from the International Development Association and the African Development Fund will be used primarily in the education and health sectors, once the net additionality has been determined.

14. The medium-term framework that underpins the 2006 budget does not envisage any nonconcessional external borrowing. However, the rate of economic growth is not sufficient for the attainment of the MDGs and the objectives of GPRS II. A minimum GDP growth of 8 percent is estimated to be needed starting in 2009, and this requires that the resource envelope underlying the current medium-term framework and the MDRI will need to be scaled-up to provide for investments in strategic areas like energy, roads, railways, and information and communications technology. Accordingly, we are developing a structured public investment framework—informed by the GPRS II—for specific essential undertakings for which we cannot obtain concessional financing. We are keenly aware of the need to exercise great care to ensure that the public external debt does not become unsustainable in the future, and that proceeds from borrowing—like all other resources—are used efficiently

and transparently. A comprehensive project analysis of each proposed investment would be carried out to ensure that the reforms are sufficient to justify the investment. In this context, we will continue to prepare the ground for future access to international capital markets.

15. Since Ghana reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in mid-2004, we have made significant progress in strengthening our debt management capacity—including the ability to assess and design loan proposals. The debt management program includes:

- Comprehensive monthly reconciliation of external debt data for all the macroeconomic sectors;
- Identification of bottlenecks for corrective measures to improve absorptive capacity;
- Financial evaluation to ensure external debt sustainability for each proposed loan, with interdepartmental discussion of the results prior to agreement; and
- Seeking appropriate technical assistance from development partners, and training our staff.

**Monetary and exchange rate policies**

16. The Bank of Ghana will continue to aim at lowering inflation to single digit by end-2006. To this end, the targeted growth of broad money is 18.3 percent, broadly in line with nominal GDP growth. Since last year, the central bank has made a number of important changes to its operating framework to increase economic efficiency and make it more likely that all commercial banks would take full advantage of market opportunities. These changes include a reduction of the secondary reserve requirement. At this stage, there is no evidence that the change has impacted on the path of the monetary aggregates, although there may be a lagged reaction as commercial banks adjust to the new environment. The central bank will remain vigilant to ensure that the monetary stance remains consistent with achieving its inflation and international reserves targets.

17. Ghana will continue to maintain a managed floating exchange rate regime, with no preannounced path for the exchange rate. Under this regime, interventions in the foreign exchange market are limited to short-term smoothing and achievement of the international reserves objective. We believe that this regime has served Ghana well. Recent real effective appreciation has not harmed Ghana’s international competitiveness, as indicated by the continued expansion of nontraditional exports and continued strong net private inflows. We have also experienced relative stability of the cedi nominal exchange rate with respect to the U.S. dollar. Under the circumstances, the central bank does not intend to undertake any action that would inhibit changes to the exchange rate as determined by the fundamentals of market forces.

**Structural policies**

18. An important element of our economic program concerns reform of the public sector in general, and the civil service in particular. As envisaged, the government has now adopted a civil service reform program that includes an action plan and timetable for implementation. The main elements of the reform program involve:

- Elimination of subvented agencies that are no longer relevant to the government's objectives; facilitation of partial or full commercialization of selected subvented agencies; and determination of the appropriate level of government subvention for the rest;
- Undertaking a comprehensive review of the wage and salary structure of the public service, that provides for the rationalization of the emolument structure, the monetization of non-monetary benefits, the standardization of job titles, and the update of job classification. The government will present a report on this review by end-June 2006.

19. The government considers that the private sector must lead growth. As indicated earlier, efforts to further consolidate the fiscal position will "crowd-in" private investment through a lowering of interest rates. However, we realize that reducing the cost of capital is only one element (albeit important) in achieving this goal. Another key element is the deepening of financial intermediation. Accordingly, the Financial Sector Strategic Plan will continue to provide the medium-term direction for reform in the financial sector—with emphasis on regulatory and judicial reform, institutional capacity building, protection of private property rights, and competition in commercial banking. Progress is being made on all these fronts, although in some areas with delays. Two pieces of legislation are especially important for reducing structural rigidities to credit growth. First, the Credit Reporting Bill is important for establishing the legal basis for gathering information on borrowers that is used to judge credit risks. The Ministry of Finance and Economic Planning has submitted the Credit Reporting Bill to cabinet for final approval by end-June 2006. The second concern is the Companies Code, which is important for establishing the legal obligation of incorporated enterprises. Also, the efficiency of the banking sector will be further enhanced with the new foreign exchange and anti-money laundering bills that are under consideration.

20. We intend to build on the progress we have made in strengthening the financial and operating performance of public enterprises. This progress reflects improvements in financial planning, monitoring, and ensuring that commercially-oriented entities maintain or adopt pricing policies that reflect full cost recovery. In the latter regard, a key element is the triennial tariff review being undertaken by the Public Utilities Regulatory Commission (PURC). This review—to be completed by year-end—will assess the parameters of the current formulae used in setting utility tariffs, the relevance of the current tariff structures, and the revaluation of the utility companies' assets and its potential impact on cost recovery.

21. Last year, the operations of the Volta Aluminum Company (VALCO)—now state-owned—were restarted, and production started in early 2006. In our view, VALCO will play an important role in Ghana's development through its backward integration with the aluminum industry (in particular, the mining and processing of Ghana's vast bauxite deposits, which will also create significant employment opportunities in areas where there is widespread poverty). The Volta River Authority (VRA) will supply VALCO with electricity at rates that are below its cost recovery. This quasi-fiscal activity will be financed through explicit budgetary provisions to VRA. To the extent that VRA's overall profit increases, corresponding dividends will be included in the budget. This approach, we recognize, is important for transparency and to avoid the depletion of assets. It is envisaged that Alcoa (the government's strategic partner in VALCO) will build a dedicated power plant to supply the

aluminum smelter with some of its power requirements, thereby lowering the required subsidy from the budget over the medium term.

**Program monitoring**

22. Quantitative and structural performance criteria and structural benchmarks for 2006 are set out in Tables 3 and 4. The sixth review of the program is expected to be completed by September 2006, with end-June 2006 as the test date for the quantitative performance criteria. Detailed definitions and reporting requirements for all performance criteria and structural conditions are contained in the updated Technical Memorandum of Understanding (TMU) attached to this letter.

23. We believe that the policies specified forth in this letter provide a basis for sustaining growth, reducing inflation, and alleviating poverty—but we stand ready to take additional measures if required. The government will provide the Fund with the information needed to assess progress in implementing our program as specified in the TMU, and will consult with the Fund staff on any measures that may be appropriate at the initiative of the government or whenever the Fund requests a consultation. The government intends to make this letter, the TMU, and the staff report for the fourth and fifth reviews available to the public. In this context, it authorizes the IMF to arrange for them to be posted on the Fund's website, subsequent to Executive Board completion of the reviews.

24. Accordingly, we are requesting completion of the fourth and fifth reviews, and disbursement of the fifth and sixth loan installments, totaling SDR 52.70 million.

Yours sincerely,

s/

Hon. Kwadwo Baah-Wiredu, MP
Minister of Finance and Economic Planning

s/

Dr. Paul A. Acquah
Governor, Bank of Ghana

Attachments (5)

Table 1. Ghana: Quantitative Performance Criteria and Indicative Targets, PRGF Arrangement, 2005 1/
(Cumulative flows from beginning of calendar year 2005 to end of month indicated, unless otherwise indicated)

| | End-June | | | End-September | | End-December | | |
|---|---|---|---|---|---|---|---|---|
| | Perf. criterion 2/ | Actual | Status | Indicative 2/ | Actual | Perf. criterion 2/ | Prel. | Status |
| Performance criteria | | | | | | | | |
| Net domestic financing of government (ceiling) | -237 | 1,236 | Not met | -1,374 | 970 | -996 | -1,541 | Met |
| Net domestic assets of the Bank of Ghana (ceiling) 3/ | 1,170 | 1,163 | Met | 2,095 | 210 | 444 | -1 | Met |
| Stock of net domestic banking sector credit to TOR (ceiling) | 568 | 445 | Met | 600 | 652 | 600 | 950 | Not met |
| Net international reserves of the Bank of Ghana (floor) | -217 | -138 | Met | -283 | 21 | 130 | 309 | Met |
| The contracting or guaranteeing of new nonconcessional external debt with original maturity greater than or equal to 1 year by the government or the Bank of Ghana (ceiling) 4/ | 0 | 0 | Met | 0 | 0 | 0 | 0 | Met |
| Outstanding stock of external debt with original maturity of less than one year owed or guaranteed by the government or the Bank of Ghana (ceiling) 5/ | 100 | 25 | Met | 100 | 0.1 | 100 | 47 | Met |
| Stock of external payment arrears (ceiling) 6/ | 0 | 0 | Met | 0 | 0 | 0 | 0 | Met |
| Wage bill of the central government (ceiling) 7/ | 3,747 | 3,740 | Met | 6,447 | 5,928 | 8,832 | 8,392 | Met |
| Indicative targets | | | | | | | | |
| Government domestic primary balance (floor) | 1,598 | 1,060 | Not met | 2,109 | 653 | 2,532 | 3,268 | Met |
| Reserve money stock (ceiling) | 8,313 | 7,968 | Met | 8,633 | 8,433 | 10,777 | 10,140 | Met |
| Government revenue, excluding grants and divestiture proceeds (floor) | 10,646 | 9,864 | Not met | 16,886 | 15,235 | 23,911 | 23,156 | Not met |
| Poverty related expenditures (floor) | 3,549 | 3,124 | Not met | 5,758 | 5,451 | 8,014 | 8,256 | Met |

1/ Definitions of line items and terminology are elaborated in the technical memorandum of understanding. Variables are measured at end of month values, unless otherwise indicated.
2/ EBS/05/79.
3/ Based on a fixed exchange rate of 9,177.0 cedis/U.S. dollar, the rate prevailing at end-March 2005.
4/ This is a continuous performance criterion. It applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted by Decision 12274-(00/123) of August 24, 2000 but also to commitments or contracted for which value has not been received, as specified in paragraph 19 of the TMU.
5/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted by Decision 12274-(00/123) of August 24, 2000, as specified in paragraph 18 of the TMU.
6/ This is a continuous performance criterion. The TMU stipulates the precise program definition of payment arrears.
7/ Cumulative from January 2005, and including subvented agencies, all allowances (including additional duty hour allowance), and clearance of all wage arrears from 2004 amounting to 149 billion cedis.

Table 2. Ghana: Structural Performance Criteria and Benchmarks for 2005 1/

| Conditionality | Status |
|---|---|
| **Performance criteria** | |
| • **End-September 2005.** Establish computerized integrated personnel and payroll databases, which will include all employees covered under the Ghana Universal Salary Structure (GUSS) and all subvented agencies (such as the police, universities, and research centers). | **Done.** By end-December 2005, the computerized integrated personnel payroll databases had been completed. The full migration from the existing integrated personnel and payroll database (IPPD1) to the new IPPD2 is expected by end-June 2006. |
| • **By December 31 2005.** Cabinet to approve the final plan for the civil service reform covering human resource policy, reviewing the organization and structure of the civil service, and addressing wage policy and payroll management (including pensions) (in line with paragraphs 28 and 29 of the MEFP). | **Done.** Cabinet approved the revised civil service reform plan in October 2005. |
| **Benchmarks** | |
| • **Continuous.** Starting January 1, 2006. Bank of Ghana will start to enforce compliance of commercial banks with the capital adequacy stipulated in the Bank of Ghana Law and Banking Act. Noncomplying banks must take timely remedial actions, or their licenses will be revoked. | **Being implemented.** Noncomplying banks are expected to take timely remedial actions. In any event, Bank of Ghana has publicly notified that commercial banks who fail to meet the minimum capital requirements (cedi 70 billion) by end-December 2006 would have their licenses revoked. |
| • **By end-December 2005.** The Minister of Finance and Economic Planning (MOFEP) will issue an Administrative Directive to expand the mandate of the Non-Tax Revenue Unit at the Ministry of Finance and Economic Planning to monitor—on a quarterly basis—the financial and operating performance of the 35 state-owned enterprises that now report to the State Enterprise Commission (SEC), as well as any other key public enterprises so determined by the Minister of Finance and Economic Planning (in line with paragraph 25 of the MEFP). | **Done.** The Administrative Directive was issued by the Minister in August 2005. MOFEP Non-Tax Revenue Unit and the SEC are working to establish a template for quarterly reporting of SOE data (to begin in the first quarter of 2006). |

1/ EBS/05/79; and data and information provided by the Ghanaian authorities.

Table 3. Ghana: Quantitative Performance Criteria and Indicative Targets, PRGF Arrangement, 2006 1/
(Cumulative flows from beginning of calendar year 2006 to end of month indicated, unless otherwise indicated)

| | End-March | End-June | End-September | End-December |
|---|---|---|---|---|
| | Est. | Perf. criterion | Indicative | Indicative |
| | (In billions of cedis) | | | |
| Performance criteria | | | | |
| Net domestic financing of government (ceiling) | 1,640 | 2170 | 870 | 215 |
| Net domestic assets of the Bank of Ghana (ceiling) 2/ | -1,110 | -4,376 | -5,086 | -1,939 |
| Stock of net domestic banking sector credit to TOR (ceiling) | 950 | 950 | 300 | 200 |
| | (In millions of U.S. dollars) | | | |
| Net international reserves of the Bank of Ghana (floor) | 52 | 165 | 225 | 160 |
| The contracting or guaranteeing of new nonconcessional external debt with original maturity greater than or equal to 1 year by the government or the Bank of Ghana (ceiling) 3/ | 0 | 0 | 0 | 0 |
| Outstanding stock of external debt with original maturity of less than one year owed or guaranteed by the government or the Bank of Ghana (ceiling) 4/ | 50 | 100 | 100 | 100 |
| Stock of external payment arrears (ceiling) 5/ | 0 | 0 | 0 | 0 |
| | (In billions of cedis) | | | |
| Wage bill of the central government (ceiling) | 2,498 | 5,387 | 7,588 | 9,990 |
| Indicative targets | | | | |
| Reserve money stock (ceiling) | 10,088 | 9,600 | 9,720 | 11,900 |
| Poverty related expenditures (floor) | 1,865 | 4,242 | 6,680 | 11,187 |

1/ Definitions of line items and terminology are elaborated in the technical memorandum of understanding. Variables are measured at end of month values, unless otherwise indicated.
2/ Based on the official end-March exchange rate 9,138.8 cedis/U.S. dollar.
3/ This is a continuous performance criterion. It applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted by Decision 12274-(00/123) of August 24, 2000 but also to commitments or contracted for which value has not been received, as specified in paragraph 20 of the TMU.
4/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted by Decision 12274-(00/123) of August 24, 2000, as specified in paragraph 19 of the TMU.
5/ This is a continuous performance criterion. The TMU stipulates the precise program definition of payment arrears.

Table 4. Ghana: Structural Performance Criterion and Benchmark for 2006

| Conditionality | Status |
| --- | --- |
| **Performance criterion** | |
| • **End-June 2006.** Present a report on the comprehensive review of the wage and salary structure of public service workers that provides for the rationalization of the emolument structure, the monetization of non-monetary benefits, the standardization of job titles, and the update of job classification. | |
| **Benchmark** | |
| • **End-June 2006.** The Ministry of Finance and Economic Planning will submit the Credit Reporting Bill to cabinet for final approval. | |

## Technical Memorandum of Understanding

1. This technical memorandum of understanding contains definitions that are intended to clarify the measurement of items in Table 3, Quantitative Performance Criteria and Indicative Targets, PRGF Arrangement, 2006, attached to the Letter of Intent. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from December 31, 2005.

### Provision of data to the Fund

2. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff on a monthly basis with a lag of no more than eight weeks (except for select data for which the reporting lag is explicitly specified in Table 5). The authorities will transmit promptly to Fund staff any data revisions. For any information (and data) that is (are) relevant for assessing performance against program objectives but is (are) not specifically defined in this memorandum, the authorities will consult with Fund staff.

### Definitions

3. **Government** is defined for the purposes of this memorandum to comprise the central government as well as all special funds (the Education Trust Fund, the Road Fund, the District Assembly Common Fund, and the National Health Insurance Fund) and various subvented and other government agencies that are classified as government in the Bank of Ghana (BOG) Statement of Accounts (SOA). The Social Security and National Insurance Trust (SSNIT) and public enterprises, including Cocobod, are excluded from the definition of government. With regard to government deposits in commercial banks, the BOG's definition of government, circulated to commercial banks in May 2004, will apply for program purposes.

4. **Government domestic revenue** comprises all tax and nontax revenues of the government (in domestic and foreign currency), excluding foreign grants and divestiture receipts. Revenue will be measured on a cash basis as gross inflows to the government's uncommitted treasury collections accounts (as reported by the BOG).

5. **Government domestic expenditure** comprises all spending from uncommitted accounts for Items 1-4, as captured by the accounts of the Controller and Accountant General's Department (CAGD), transfers, payments to statutory funds, HIPC-financed expenditure, and VAT refunds. Reporting will be based on the current National Expenditure Tracking System (NETS) accounting system and its associated 15-digit chart of accounts and will be fully reconciled with BOG bank statements on spending (outflows) from the 42 newly created ministries, departments, and agencies' (MDA's) operational accounts (plus any residual use of existing treasury drawing/overdraft accounts). Expenditure will also be verified by comparing it with accounts produced by the Budget and Public Expenditure Management System (BPEMS) accounting system, until such time as it becomes fully operational.

6. **The government will continue to report poverty-related expenditures,** including the use of funds from the enhanced Heavily Indebted Poor Countries (HIPC) Initiative.

Budgeted poverty spending for these categories will be taken from each year's final appropriations bill and will include spending financed by the government or donors or from internally generated funds. Actual poverty-related spending will be identified using the last 3 digits of the 15-digit chart of accounts of the CAGD's current NETS and the subcomponent that is financed through HIPC Initiative debt relief. These data will be supplemented with that proportion of transfers to the District Assembly Common Fund, the Ghana Educational Trust Fund, and the Road Fund, which are deemed by those entities to be poverty-related. Accordingly, actual poverty spending will exclude some donor-supported expenditure not currently captured by the CAGD (including, among others, the pooled donor health fund).

7. **Net domestic financing of government** is defined as the change in net credit to government by the banking system (i.e., the Bank of Ghana plus deposit money banks) plus the net change in holdings of treasury bills and other government securities by the nonbank sector, including deferred accrued-interest payments on inflation-indexed bonds but excluding divestiture receipts. Such credit will also exclude treasury bills issued for open market operation purposes from January 1, 2003 onward (the holdings of which are excluded from the BOG Treasury Department's Debt Registry of central government securities, and the proceeds of which are sterilized in deposits held as other BOG liabilities, as defined in the monetary template provided to the IMF on December 3, 2003).

8. **Outstanding net credit to the government by the Bank of Ghana** comprises the sum of claims on government (SOA codes 0401 and 050101-4), including overdrafts of the government with the BOG and deferred accrued interest on BOG holdings of inflation-indexed bonds, less government deposits (1101 including the main HIPC Initiative receiving account, and 1202) as defined in the monetary template.

9. **Outstanding net credit by deposit money banks** comprises deposit money bank (DMB) holdings of government securities at cost of purchase value, as reported by the BOG Treasury Department's Debt Registry, plus overdrafts less government deposits as reported by DMBs in the revised BSD2 report forms (and defined in the Monetary Template), plus deferred accrued interest on their holdings of inflation-indexed bonds.

10. **Nonbank financing** is the difference between total net cash receipts to the treasury main cash account (issues/redemptions account when it becomes operational) from the sale/repurchase of government securities, less the corresponding net cash value received from the BOG and DMBs as indicated on the Debt Registry by holder at discount value, plus deferred accrued interest on their holdings of inflation-indexed bonds. For each test date, any adjustment by the BOG to the data reported by individual DMBs, on account of their misclassification of government or for other reasons, will be reported to the Fund.

11. The **domestic primary balance** is defined as the difference between government domestic revenue and noninterest domestic government expenditure as reported by the CAGD. It will exclude foreign-financed capital expenditure, for which data are reported by the Aid and Debt Management Unit (ADMU). The measurement will be on a cash basis, with any positive (negative) discrepancy between the above- and below-the-line measure of the overall balance being added to (subtracted from) the measure of the domestic primary balance (including unspent balances remaining in committed accounts).

12. The **wage bill of the government** is defined as the sum of personal emoluments and Item 1 under the contingency expenditure, plus amounts identified as salary-related allowances less salary suspense account, all provided by the CAGD in "Report and Financial Statements on the Public Accounts of Ghana (Consolidated Fund)." The wage bill is to include all remunerations (plus the Additional Duty Hourly Allowance) paid to civil servants covered under the Ghana Universal Salary Structure (GUSS) and subvented agencies.

13. **Net domestic credit to the Tema Oil Refinery (TOR)** from the banking system will be defined as total advances to TOR by deposit money banks (including overdrafts and letters of credit), less TOR's deposits with deposit money banks, and will be reported by the Research Department of the Bank of Ghana.

14. The **program exchange rate** for the purposes of this memorandum will be 9,138.8 cedis per dollar, which was the official exchange rate prevailing at end-March 2006.

15. **Reserve money** is defined as the sum of currency in circulation (BOG statement of accounts codes 901 plus 902), plus cedi-denominated currency deposits at the BOG (excluding accounts that are overdrawn, blocked, or owned by banks in liquidation) of the following entities: commercial banks, other financial institutions, private sector entities, public institutions, and public enterprises. A more detailed listing of accounts to be included in the measure of reserve money is contained in the monetary template referred to in paragraph 7. If aggregate reserves fall below the legal reserve requirement of 9 percent of bank deposits (as reported in the quarterly STCRBB), then reserve money will be adjusted upward to the extent of any shortfall in compliance with that reserve requirement.

16. **Net foreign assets** are defined in the monetary survey as short- and long-term foreign assets minus liabilities of the BOG that are contracted with nonresidents. Short-term foreign assets include: monetary gold (valued at the spot market rate for gold, US$/fine ounce, London), holdings of SDRs, reserve position and HIPC Initiative trust investment in the IMF, the HIPC Initiative Umbrella SDR account (all as reported by the IMF), foreign notes and travelers checks, foreign securities, positive balances with correspondent banks, and other positive short-term or time deposits. Short-term foreign liabilities include foreign currency liabilities contracted by the BOG at original maturities of one year or less (including overdrafts), outstanding liabilities to the IMF, and deposits of international institutions at the BOG. Long-term foreign assets and liabilities are comprised of: other foreign assets (BOG statement of accounts code 303), investments abroad (a subset of 60201), other long-term liabilities to nonresidents (a subset of 1103), and bilateral payment agreements (305). All values not in U.S. dollars are to be converted to U.S. dollars at the exchange rates prevailing at end-March 2006 and then into cedis at the program exchange rate indicated in paragraph 14. A more detailed listing of accounts to be included in the measure of net foreign assets is contained in the monetary template referred to in paragraph 7 above.

17. **Net international reserves** of the BOG are defined for program monitoring purposes and in the balance of payments as short-term foreign assets of the BOG, minus short-term external liabilities. To the extent that short-term foreign assets are not fully convertible external assets readily available to and controlled by the BOG (that is, they are pledged or otherwise encumbered external assets, including, but not limited to, the HIPC umbrella SDR

account, they will be excluded from the definition of net international reserves. Net international reserves are also defined to include net swap transactions (receivable less payable) and exclude all positive foreign currency deposits at the BOG held by resident deposit money banks, public institutions, nonfinancial public enterprises, other financial institutions, and the private sector. All values not in U.S. dollars are to be converted to U.S. dollars at the exchange rates prevailing at end-March 2006 and then into cedis at the program exchange rate indicated in paragraph 14. A more detailed listing of accounts to be included in the measure of net international reserves is contained in the monetary template referred to in the paragraph above.

18. **Net domestic assets** of the Bank of Ghana are defined as the difference between reserve money and net foreign assets of the BOG, excluding the HIPC Umbrella SDR account, converted from U.S. dollars to cedis at the program exchange rate.

19. The performance criterion on **short-term external debt** refers to the outstanding stock of external debt with an original maturity of one year or less, including overdraft positions and debt owed or guaranteed by the government or the BOG.[1] Data on the BOG's short-term external debt are those reported from the statement of accounts template as short-term liabilities to nonresident commercial banks (BOG statement of accounts code 1201 plus 301 overdrafts plus Crown Agent).

20. The performance criterion on **nonconcessional medium- and long-term external debt** (Table 3) refers to the contracting or guaranteeing of external debt with an original maturity of more than one year by the government or Bank of Ghana.[2] Medium- and long-term debt and its concessionality will be reported by the Aid and Debt Management Unit of the Ministry of Finance and Economic Planning, and will be measured in U.S. dollars at current exchange rates.

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[1] (A) The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000). This includes overdrafts on accounts with correspondent banks. (B) Excluded from this performance criterion are normal import-related credits, pre-export financing credits of public enterprises, cocoa loans collateralized by cocoa contracts, and individual leases with a value of less than US$100,000.

[2] (A) This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received.
(B) Excluded from this performance criterion are: individual leases with a value of less than US$100,000; debts with a grant element equivalent to 35 percent or more, calculated using currency-specific discount rates based on OECD commercial interest reference rates; a loan (not exceeding US$30 million) that may be guaranteed by the government for the Northern Ghana Groundnut Project. The grant element of each loan will be assessed only with regard to (i) the interest rate and repayment schedule of the loan and (ii) any grants or other concessional loans provided by a foreign official entity in connection with the loan in question. Loans provided by a private entity will not be considered concessional unless accompanied by a grant or grant element provided by a foreign official entity equal to at least 35 percent of the combined loan.

21. **External payment arrears** are deemed to accrue when undisputed interest or amortization payments of the government are not made within the terms of the contract, or in conformity with the terms for interim relief provided under the enhanced HIPC Initiative and the deferral agreed with the Paris Club on December 10, 2001.

**External Data, Debt and Debt Service, HIPC Relief, and MDRI Relief**

22. **To improve the transparency and accountability of external debt management,** the Minister of Finance and Economic Planning has written to the Controller and Accountant General and the Governor of the BOG setting down the formal procedures for settlement of debt and specifying the functions that the CAGD and the BOG are expected to fulfill in carrying out those procedures. In addition, the following measures have been initiated and will be maintained:

(a) All MDAs have been informed that the ADMU in the Ministry of Finance and Economic Planning is the only entity authorized to contract or guarantee external debt, and all leases with a total value above US$100,000 should be submitted to ADMU for authorization. The ADMU will report to the IMF with a lag of not more than one month on the concessionality of all new loans contracted.

(b) The Minister of Finance and Economic Planning has sent a circular to all donor desks officers in the Minister of Finance requesting that arrangements be put in place to ensure that the ADMU is informed of all correspondence with creditors, including the latest information on disbursements and project financing developments and any notices of payment due. All new loan documents should also state clearly that the ADMU is the main initial point of contact for settlement of all debt obligations.

(c) Formal procedures have been established requesting donors and creditors to confirm with the ADMU debt-payment obligations—including for government-guaranteed obligations—in advance of payment due dates.

(d) Formal delegations have been put in place in the Ministry of Finance and Economic Planning and at the CAGD to ensure that an absence of signing authority does not delay payment requests. In addition, a register will be kept of the timing of formal debt-payment actions. This register should be signed by the various institutions involved in the payment of external debt.

(e) At the same time, procedures instituted in early 2003 relating to prior authorization and fiscal booking of external and other payments by direct debit will be maintained.

(f) In the event that a shortage of foreign exchange results in a queuing of debt-service obligations at the BOG, delaying payments beyond their due dates, the Ministry of Finance and Economic Planning is responsible for issuing any instructions needed to revise payment priorities and for maintaining a record of payment arrears. Formal reporting and follow-up procedures have been established for the BOG to confirm the transactions to CAGD and the ADMU in the MoFEP on a daily basis. These reports contain information on the transactions completed as requested, transactions previously queued and paid, and transactions added to the queue. These reports are copied to both the Governor of the BOG and the Minister of Finance and Economic Planning and his senior officials and to the IMF staff on a monthly basis.

(g) The procedures for verifying BOG data to the Fund have been formalized, and a senior officer has been formally delegated with the responsibility for the compilation and verification of data on program conditionality to be reported. Formal reconciliation procedures to verify both the derivation of data reported to the Fund and the BOG internal audit procedures have been amended to include a periodic check that procedures are followed.

(h) **Two accounts** have been established at the BOG for the receipt and disbursement of HIPC Initiative relief. When each debt-service payment falls due, the government of Ghana (or the BOG for IMF repurchases) will transfer to the account that proportion of the amount due that, under the terms of the HIPC Initiative, does not have to be paid to the creditor. For debt owed by public enterprises under the HIPC Initiative, the Government of Ghana will transfer to the HIPC Initiative account the debt-relieved portion of the debt service payment, if the enterprise fails to do so on the due date. The ADMU will issue, in advance of the due date, a request for payment to the CAGD indicating the portions due to the creditor and the HIPC Initiative account. The ADMU will prepare a monthly report indicating for the coming month (i) the total debt service due by creditor, (ii) the amount of HIPC Initiative relief on each transaction, and (iii) the debt service paid and the transfers to the HIPC Initiative account by creditor for the previous month. This report will be provided within two weeks of the end of the month to the CAGD and the IMF.

(i) For the purpose of tracking the use of MDRI resources (including those for poverty-reducing spending), a sub-account of the government's consolidated fund account with the Bank of Ghana will be established (at the Bank of Ghana) for the receipt and disbursement of such MDRI resources.

Table 5. Ghana: Data to be Reported to the IMF

| Item | Periodicity |
| --- | --- |
| **Fiscal data** (to be provided by the MOFEP) | |
| Central budget operations for revenues, expenditures and financing. | Monthly, within six weeks of the end of each month. |
| Functional breakdown by Ministry, Department, and Agency of expenditure authorizations, payment vouchers issued, payment vouchers liquidated, and arrears. These data will also identify poverty-related and expenditures financed through the HIPC Initiative, as well as the inflows and disbursements from the HIPC receiving and drawing accounts at the BOG. | Monthly, within six weeks of the end of each month. |
| Divestiture receipts received by the budget (in cedis and foreign exchange, net of divestiture transactions costs). | Monthly, within six weeks of the end of each month. |
| **Monetary data** (to be provided by the BOG) | |
| Net domestic assets and net international reserves of the BOG. | Monthly, within two weeks of the end of each month. |
| Detailed balance sheet of the monetary authorities. | Monthly, within four weeks of the end of each month. |
| Monetary survey detailing the consolidated balance sheet of commercial banks using the new BSD2 Report Form. | Monthly, within six weeks of the end of each month. |
| Summary position of government committed and uncommitted accounts at BOG, as well as total financing from BOG. Accompanying table showing composition of other receipts and other expenditure. | Monthly, within four weeks of the end of each month. |
| Composition of banking system and nonbanking system net claims on government. | Monthly, within four weeks of the end of each month. |
| Debt registry showing structure and holders of domestic government debt, at face value and at discount. Similar table showing holders of treasury bills for open market operations. | Monthly, within four weeks of the end of each month. |
| **Balance of Payments** (to be provided by the BOG) | |
| Export and import data on value, volume, and unit values, by major categories and other major balance of payments variables. | Quarterly, with a maximum lag of two months. |

Table 5. Ghana: Data to be Reported to the IMF (concluded)

| | |
|---|---|
| Foreign exchange cash flow. | Monthly, within four weeks of the end of the month. |
| **External debt and foreign assistance data (to be provided by MOFEP)** | |
| Information on the concessionality of all new external loans contracted by the government or with a government guarantee. | Monthly, within four weeks of the end of each quarter. |
| For the coming quarter: (i) total debt service due by creditor, (ii) amount of HIPC Initiative relief on each transaction, and (iii) debt service paid and the transfers to the HIPC Initiative account by creditor for the previous month. Report should cover government and government-guaranteed debt (as defined in this document). | Quarterly within four weeks of the end of each quarter. |
| External debt and external debt service incurred by enterprises with government ownership above 50 percent, even if loans have not been explicitly guaranteed by the government. | Quarterly, within three weeks of the end of each quarter. |
| Disbursements of grants and loans by creditor | Quarterly, within four weeks of the end of each quarter. |
| **Other data** (to be provided by GSS) | |
| Overall consumer price index. | Monthly, within two weeks of the end of each month. |
| National accounts by sector of production, in nominal and real terms. | Annual, within three months of the end of each year (switching to quarterly when they become available). |