

Chapter 3

Structural Adjustment in Ghana

This chapter sets Ghana into the context of the Sub-Saharan Africa region, narrates the history of structural adjustment in Ghana, and reviews the literature as to the reasons of the poor macroeconomic performance in the 1990s.

3.1 The economies of Sub-Saharan Africa

To create a context for the case study proposed, this section provides an overview of the economic and institutional specifics of the countries of Sub-Saharan Africa.

Probably the most well known characteristic of Sub-Saharan Africa as a region is the extent to which its growth performance during the last three decades has lagged below that of other regions. As a result of the combination of slow GDP growth rates with fast population growth, many African countries that were middle-income, comparable to the South Asian nations in the fifties and sixties have since become low-income countries with average per capita GDP growth below one percent and often negative.

Collier and Gunning [1999] provide a detailed discussion of different explanations advanced to explain that poor performance. On the domestic side, the governments were typically undemocratic and “captured by the educated, urban-resident population, with few agricultural or commercial interests. They expanded the public sector while imposing wide-ranging controls on private activity. [...] Since public sector employment was the main priority, [...] Africa experienced the paradox of poor public services despite relatively high public expenditure”. That, in turn, led to increasing transaction costs (for transactions such as transport, telecommunication and contract enforcement) and missing infrastructure, making private manufacturing unattractive. This situation continues to hold to this day, and is quoted as an important reason why private investment in Africa remains significantly below that of other countries with comparable income levels.

Also, “since the political base of the governments was urban, agriculture was heavily taxed and the public agronomic research [...] was neglected”. As on the one hand the population was predominantly rural, and on the other hand agricultural exports were for many countries the principal source of foreign exchange (necessary to buy intermediate inputs and capital goods for the domestic industries), that combination of policies typically led to decline in GDP and a balance of payments crisis. These are the major ways in which misguided domestic policies contributed to economic decline.

As a consequence, since the late 1970s the countries of Sub-Saharan Africa increasingly made use of loans from the International Monetary Fund and the World Bank as a solution to their

balance of payments crises, and therefore were increasingly led to implement the set of policy measures advocated by these institutions, discussed above.

Sender [1999] critically discusses the consequences of these policy measures. His main criticism is that “Public investment as a share of GDP in Sub-Saharan Africa is now much lower than in any other region of the world. This has had negative effects on both the volume and the productivity of private investment in the region, because of the well-established complementarity between these two categories of investment. [...] Far too little attention has been given to the accumulation of evidence suggesting a causal relationship between the macroeconomic stabilization programs of the International Monetary Fund and declines in investment ratios”.

As far as the external connections of the economies in question are concerned, African countries’ exports were and remain concentrated in a few primary commodities, whose prices are notoriously volatile. (In a classification by Taylor [1988] of countries undergoing structural adjustment, the “externally strangled small primary product (or labor) exporters” category contained all African countries of the sample.) As Deaton [1999] points out, as a result of price-inelastic demand functions for primary commodities the variance of price can equal several times the variance of supply. For the exporting country, an upward spike in prices can then prove as difficult to manage as a downward spike, as the former easily leads to Dutch disease as well as tempting the government to enter commitments that cannot be upheld once the boom is over.

The neoclassical policy advice further encouraged expansion of primary commodity exports for all African countries on the basis of comparative advantage arguments. While neoliberal policies emphasizing export-led growth were often effective in the short term, in the medium term the simultaneous expansion in supply in fairly price-inelastic markets led to a continuous decrease in the terms of trade. Borenszstein et al. [1994] finds a secular downtrend in non-oil commodity prices since the mid-1970s. They further find that the supply expansion explains about 40 percent of the price change in the period 1971-1984, and over 60 percent in the period 1985-88. It is thus indeed primarily the supply expansion and not, say, efficiency increases or changes in demand by the industrial countries that is the primary cause of the adverse terms of trade trend.

Commodity price shocks also have immediate and far-reaching distributional effects, depending on the identity of the exporters (who can be small cocoa farmers or large mining companies) and the linkages of the export sector to the rest of the economy. Both of these factors are clearly country-specific.

3.2 The case of Ghana

The experience of Ghana during the last decades is largely representative of Sub-Saharan Africa as a whole. Population growth in Ghana was largely in line with the rest of the region, well above the low-income average (Figure 3.1).

Gross economic mismanagement during the 1970s led to an exchange rate that was almost 1000% overvalued and thus “not so much wrong as irrelevant to economic calculation” [Taylor 1988]. As a result, cocoa production, which was the main source of foreign exchange, had dropped drastically; domestic industries were unable to operate due to lack of parts and intermediate inputs.

After a turbulent period in 1978-1981 that saw several regimes come and go, Flt.-Lt. Jerry Rawlings came to power in a military coup on 31. December 1981. The first year of his rule consisted of what Gyimah-Boadi and Jeffries [2000] call “distributionist-cum-populist mobilization”, comprising large doses of vigilante justice aiming to root out corruption and restore economic justice. “The goods of hapless traders accused by vigilantes of hoarding and overpricing were con-

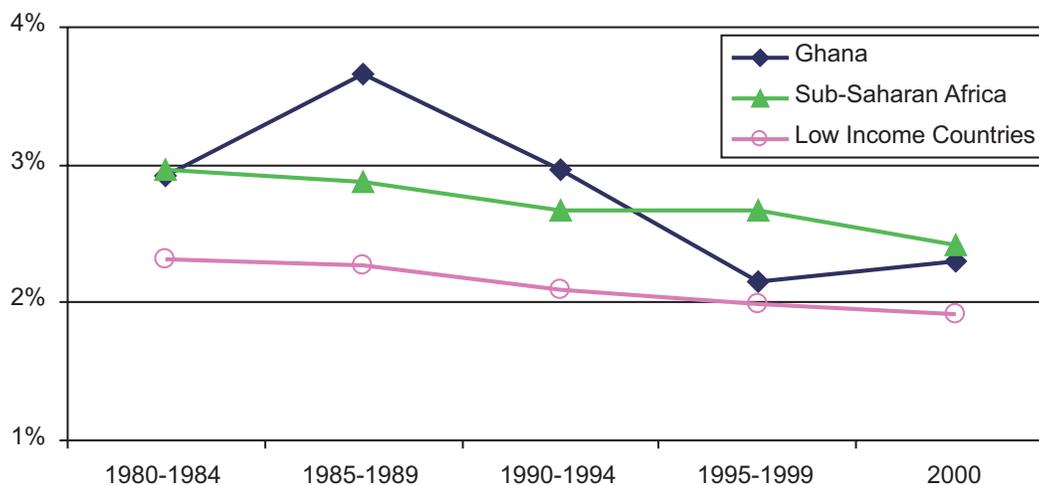


Figure 3.1: *Population Growth, Annual* (World Development Indicators 2002)

fiscated and sold off to the public at reduced prices. In somewhat extreme but certainly dramatic cases, traders' sheds and tables were destroyed and whole markets (tagged as 'dens of corruption' and symbols of the discredited commercial order) were razed to the ground." [Gyimah-Boadi and Jeffries 2000, p.43]

However, after a year of such policies, which also coincided with a severe drought and a huge repatriation of Ghanaians from Nigeria in 1983, the government decided to change course and seek foreign assistance. It first approached the Soviet block, but was advised by them to turn to the IMF and the World Bank, which it did. The standard structural adjustment reform package (known in Ghana as the Economic Recovery Program) was proclaimed by the government, including a maxi-devaluation, fiscal austerity and tight money.

As Aryeetey and Tarp [2000] observe, reforms were designed on the basis of the neo-liberal orthodoxy, with a "particularly optimistic view about the efficacy of the market mechanism as a vehicle for promotion of efficiency and development, including misconceptions about the prevalence of institutional pre-conditions for market efficiency".

According to Aryeetey and Tarp [2000], it was taken for granted that the government had better refrain from intervening in the economy, except from taking care of macroeconomic management and a few other minimalist functions. Not much attention was given to the second-best consideration that trade and market liberalization may not increase efficiency when some markets (such as insurance and credit markets) cannot be made to function properly. Crowding out of the public by the private sector was seen as the critical impediment, and little attention went to exploring what was required to make sure the private sector would indeed respond.

The policy reforms were accompanied by "abnormally high" capital receipts from abroad, mostly from multilateral and bilateral lenders [Killick and Malik 1995], that led to overall balance of payments surpluses in spite of persistent current account deficits as much-needed imports were brought into the country. The more realistic exchange rate, combined with good weather and decreases in smuggling due to better producer prices, increased cocoa export receipts; and thanks to the lifting of the foreign exchange constraint GDP grew by as much as 5% per year (Figure 3.2).

During the 1980s, these reforms were happening in the political context of a military dictatorship. While there were attempts by various groups to resist the reforms and to launch counter-

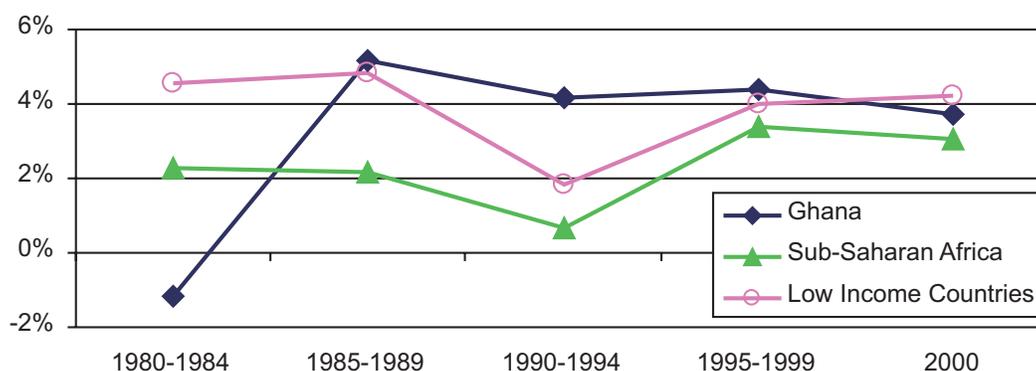


Figure 3.2: *GDP growth, Annual (World Development Indicators 2002)*

coups, none of these were able to topple the regime or even present any very effective organized opposition to the reforms. Gyimah-Boadi and Jeffries [2000] attribute that to the unusual degree of skill and determination with which the reform process was managed, as well as to the fact that the regime enjoyed a substantial degree of popular support, while also resorting to strong repressive measures to silence any opposition. Overall, Ghana in the 1980s was a relatively strong (for the region), authoritarian state.

During the late 1980s the government has embarked on a series of democratization reforms such as decentralization and the establishment of district assemblies, and the early 1990s saw a return to multi-party politics, with a national election taking place in 1992 (with the party of Jerry Rawlings, the PNDC, coming out as the winner).

Given this combination of a relatively well-functioning (if authoritarian) state, wide economic reforms, rebounding GDP and export growth, and a broad move towards decentralization and democracy, it will come as no surprise that during the late 1980s Ghana was widely touted as the “Front-runner in adjustment” [Husain and Faruquee 1994]. As a result, the behavior of the Ghanaian economy was extensively studied by both proponents and opponents of structural adjustment, resulting in substantial literature on the subject.

The democratization process continued unabated through the 1990s. The elections of 1992 were followed by the next round in 1996 (PNDC winning again), and another in 2000, when PNDC lost and peacefully transferred power to the winning party. Overall, Ghana enjoyed remarkable political stability throughout the period, with occasional protests (for example, opposing the introduction of the Value Added Tax in 1995) but no civil unrest and no systematic opposition to the economic reforms.

Given the positive political developments, it is all the more disappointing that they were not matched by economic success. Inflation remained persistently high, averaging 30% per annum in 1986-89 (Figure 3.3). In order to boost its popularity prior to the 1992 elections, the government made excessive commitments that led to egregious budget deficits during 1992-1994, further fueling inflation during that period (fortunately, that was not as strongly the case for the subsequent elections). Capital formation remained depressed, with a total investment ratio estimated to be 6-12% in 1988 [Killick and Malik 1995], and even exhibited a slight downward trend in the 1990s (Figure 7.4, p. 70). The continuing capital inflows led to debt buildup and mounting interest payments. The medium-term benefits of liberalization didn’t set in; growth turned from high in

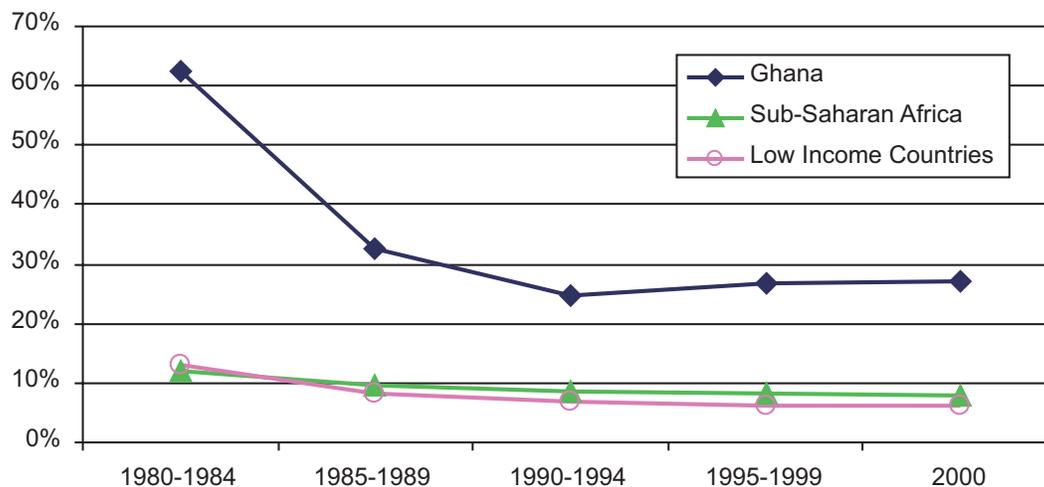


Figure 3.3: *GDP Deflator, Annual Inflation (World Development Indicators 2002)*

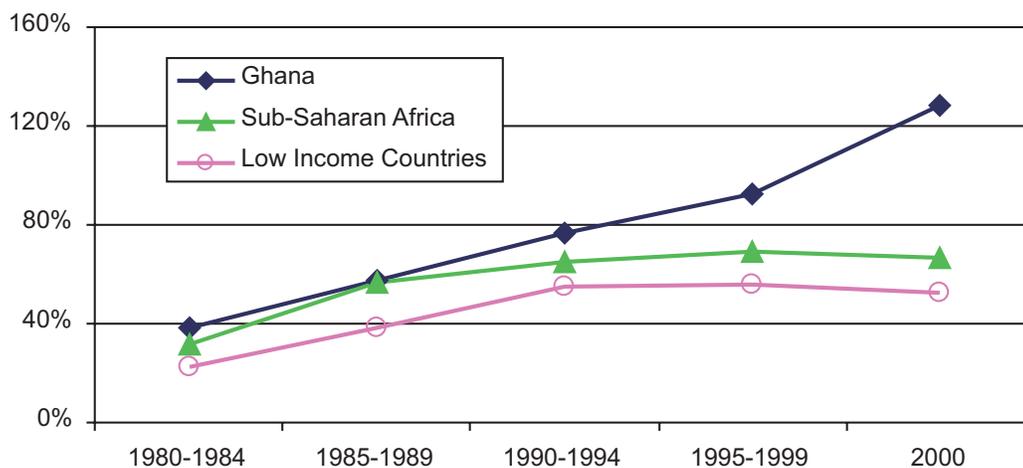


Figure 3.4: *Debt to GDP ratio (World Development Indicators 2002)*

the late 80s to lagging in early to mid-90s¹ (Figure 3.2), and external debt has increased to an extent that Ghana qualified for the Heavily Indebted Poor Countries (HIPC) initiative (Figure 3.4).

Let us discuss the key aspects of the Ghanaian economy in some more detail.

3.2.1 Fiscal Policy

Let us begin with a brief discussion of fiscal policy. As we have seen in Chapter 2, fiscal austerity is one of the pillars of structural adjustment. The average deficit values for the last four five-year periods can be seen in Table 3.1; however, it might be more informative to look at a decomposition of the deficit over time in Figure 3.5.

¹As we will see in Chapter 7, the official GDP numbers for Ghana for the 1990s are somewhat suspect. However, we use them here as part of the accepted version of events.

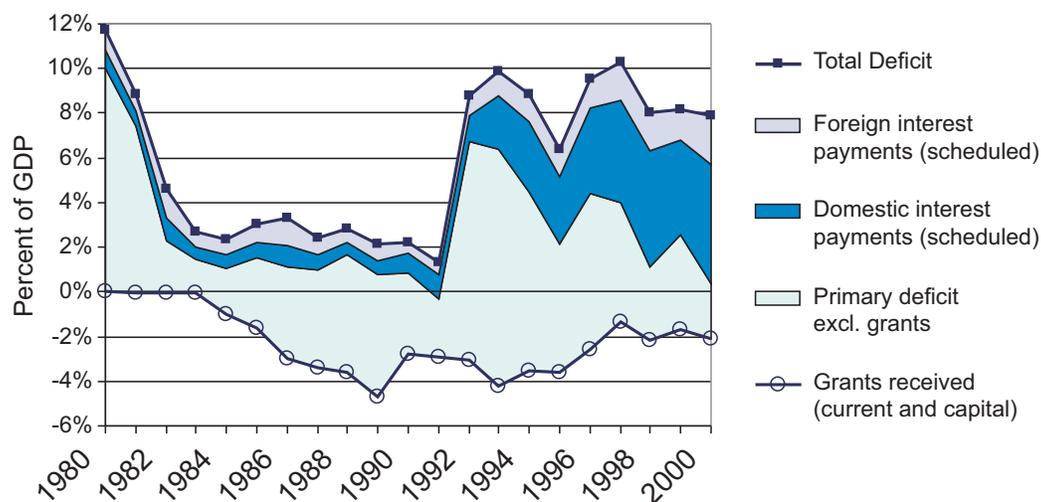


Figure 3.5: *Composition of the Fiscal Deficit (International Monetary Fund)*

	1980-1984	1985-1989	1990-1994	1995-1999	2000
Primary deficit as % of GDP	4.5%	1.2%	3.6%	2.8%	0.4%
Total deficit as % of GDP	6.0%	2.7%	5.9%	8.5%	9.7%
Broad money growth rate	32%	42%	33%	28%	35%
Nominal TB interest rate	13%	20%	27%	36%	35%
Real TB interest rate	-40%	-6%	9%	14%	17%
Effective import tariff	25%	16%	15%	14%	13%
Effective cocoa duty	51%	35%	28%	35%	14%
Exchange rate overvaluation	1279%	50%	4%	1%	0%

Table 3.1: *Indicators of Ghana's adherence to Structural Adjustment policies.*

As the figure packs quite a bit of information, let us go quickly over its contents. All values in Figure 3.5 are plotted as shares of GDP. The lowermost line (empty circles) represents the total grants received. As they *reduce* the deficit, they are plotted with a minus sign. The large area on top of that represents the primary deficit (that is, without taking into account the expenditure on interest payments) excluding grants; by stacking it onto the grants graph, its upper border represents the primary deficit including grants. Stacked on top of that there are the two areas representing interest payments on domestic and foreign debt, respectively. The topmost line (filled-in squares) is merely there to emphasize that all the areas together stack up to the total deficit.

Looking at Figure 3.5, we see several distinct periods. First, there is the period of turmoil in 1980-1982 with large deficits and no grants; then from 1984 until 1989 we see growing pre-grant primary deficits compensated by an even larger growth in grants, with the interest payments remaining comparatively small. In 1990 and 1991, grants fell, but so did the primary deficit, actually resulting in a tiny primary surplus.

Unfortunately, this fairly rosy picture unravels immediately after that. In 1992 (election year, bad cocoa harvest) revenues fell, expenditures rose, and foreign grants stayed low, leading to a huge primary deficit. The primary deficit remained high for the next couple of years, at the same time as grants were shrinking. While the primary deficit was brought under control from 1997 onwards, the interest payments on the debt accumulated during earlier excesses make sure the broad deficit never again fell under 6% of GDP, and generally stayed around 8%.

Summing up, fiscal policy during both the 1980s and the 1990s cannot really be characterized as particularly austere, with the worst excesses happening between 1992 and 1997, during the transition to democracy. As the next step in our investigation, let us see whether monetary policy was as tight as fiscal policy was austere.

3.2.2 Monetary Policy

To get a picture of monetary policy, let us look at three variables: growth rate in broad money supply, nominal interest rates (treasury bills) and real interest rates, as pictured in Figure 3.6. To compute real interest rates, we subtracted year-on-year CPI inflation from the nominal interest rates. CPI was chosen because it is the most readily available deflator, and year-on-year inflation was computed to avoid interference from the (quite strong) seasonal effects in inflation. Likewise, money supply growth is year-on-year. The averages of the same three variables over five-year periods are also reproduced in Table 3.1.

What Figure 3.6 tells us is that monetary policy since 1980 has been anything but tight. During the the 1980s, real interest rates were more often than not negative, and money supply growth rates of over 40% were quite common. Money supply has grown in the 1980s mainly because of the high foreign exchange inflows that were monetized by the Bank of Ghana, and in the 1990s primarily because of government deficits. In the 1990s, likely in reaction to the fiscal excesses, interest rates were raised somewhat, but were still occasionally negative for extended periods; and money supply growth likewise slowed down, but not by much.

High interest rate spreads between lending and deposit rates meant that real rates on deposits were even more likely to be negative than treasury bill rates, giving no incentive to save with the banks. Instead of savings accounts, holding foreign exchange was widely used as way of storing wealth, so that from 1997 BoG included forex holdings in the definition of money. [Brownbridge et al. 2000]

Stimulating credit to the private sector was one of the goals of the Economic Recovery Program.

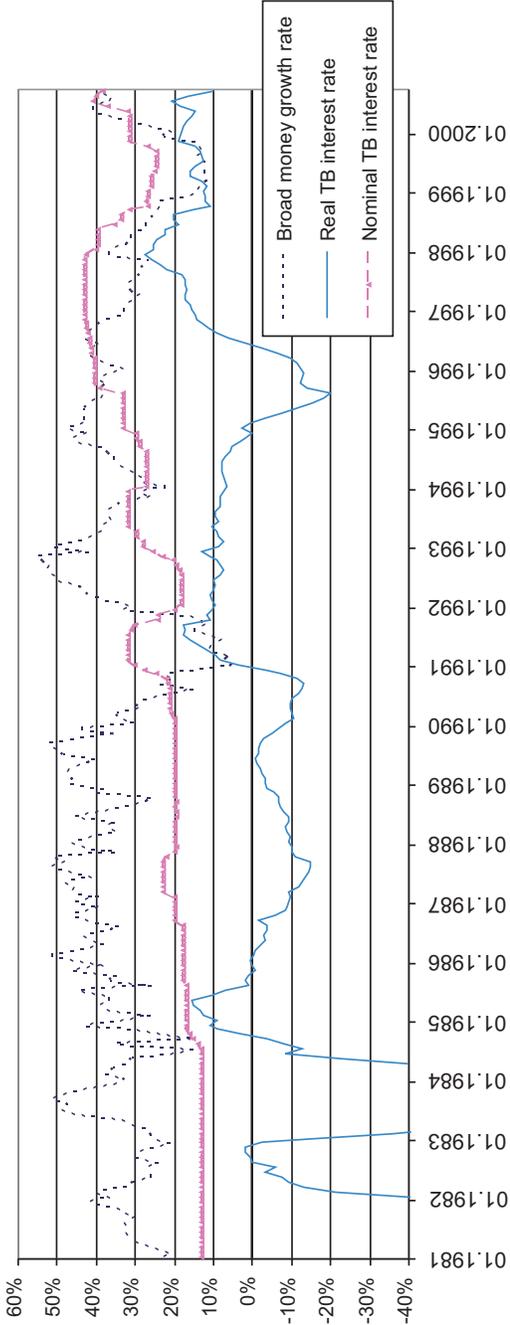


Figure 3.6: Monetary Policy Indicators

However, that was hard to achieve because of extremely high government borrowing. On the one hand, the government borrowed from the Bank of Ghana, thus increasing the money supply; on the other hand, it also borrowed from the domestic commercial banks, making commercial credit scarce. As raising interest rates on treasury bills did not increase savings much, tight restrictions on bank lending to the private sector were necessary to avoid even more money supply growth.

The Bank of Ghana had very little room for manoeuvre: If it accommodated government borrowing demand, it could only control money supply growth by constraining private sector borrowing; however the latter is only 30% of the broad money supply [Aryeetey and Harrigan 2000].

The result was a crowding out of the private sector from the credit market (although reserve requirements of commercial banks e.g. in 1993 were 52% of Bank of Ghana bills plus 5% cash, actual rates were over 70% [Aryeetey and Harrigan 2000]) and strangulation of investment. Bank credit to the private sector averaged less than 5% of GDP, and if we adjust it for the increased cost of capital goods (mostly imported), it hardly grew at all in real terms [Brownbridge et al. 2000].

What little bank lending went to the private sector financed working capital rather than investment, especially as the need for working capital went up with constant inflation and depreciation [Aryeetey and Harrigan 2000]. Discussions with private investors and executives of the Private Enterprises Foundation suggested that high nominal interest rates made firms reluctant to use loans for investment purposes, and also increased cost of operation, thus pushing up prices [Brownbridge et al. 2000]. Even though real interest rates were not that high, even in the 1990s, high nominal interest rates combined with very volatile inflation made real rates hard to predict, making borrowing to invest too risky.

From this discussion we extract two hypotheses: firstly, that interest rates had little impact on the money supply and secondly, that interest rates were a cost-push factor, and thus increasing interest rates increased inflation. We will test these hypotheses in Chapter 11.

3.2.3 Inflation

One of the persistent problems of the Ghanaian economy has been out-of-control inflation - as Figure 3.3 shows, it was almost triple the average value for either Sub-Saharan Africa or the low-income countries. Given the huge growth in money supply throughout the 1980s and 1990s, it is not surprising that this growth is usually taken as the main explanation for the high inflation rates. However, there are also dissenting opinions.

The view that money supply was the primary driver of inflation is critiqued by Sowa et al. [Sowa and Kwakye 1991, Sowa 1994, CEPA 1996], who argue that real-side factors matter more in the inflationary spiral. Their econometric regressions are used to suggest that elasticity of inflation with respect to output is almost unity, so output volatility (especially in food production, which has a weight of 50% of CPI) rather than monetary factors drive inflation.

Another supply-side explanation for the persistent inflation is the low growth rate and capacity utilization of the industrial sector. However, as Aryeetey and Harrigan [2000] remarks, that seems unlikely to be a major influence as the industrial sector is so small (less than 10% of GDP).

Upon reviewing the above supply-side arguments, Aryeetey and Harrigan [2000] concludes that they might explain the short-term jumps in inflation (for instance during a drought, such as the 60% inflation rate in 1995) but not persistent high inflation, unless there are continued high rates of monetary growth. A structuralist explanation would only be useful if it could show that the huge money supply growth rates since the start of ERP were caused by inflation rather than vice

versa.

This debate is clearly central to one of our research questions, namely understanding of inflation, and thus we expect to provide substantial evidence allowing us to evaluate the above debates. To be precise, in Chapter 11 we will address the question of the relative importance of money supply, cost factors, and inertia in determining the level of inflation.

3.2.4 Labor Market

The availability of data on labor market is much lower than that on macroeconomic indicators. No yearly data for overall employment composition are being collected in Ghana to the best of the author's knowledge. The only source of employment composition data are various surveys happening at irregular intervals. The most detailed of these is the Ghana Living Standards Survey (GLSS), of which a total of four rounds have been conducted, in 1987, 1988, 1991 and 1998.

Figure 3.7 shows the composition of the labor force in absolute and percentage terms.

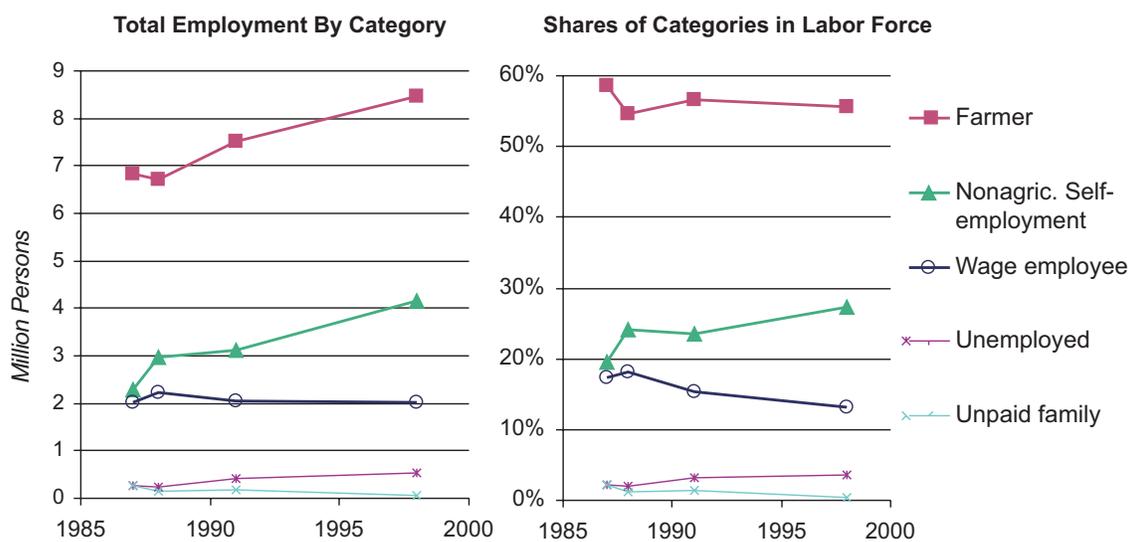


Figure 3.7: *Employment composition (GLSS1-4 and author's estimates)*

We see that the majority of the population are farmers, followed by non-agricultural self employment (transport, personal services, etc. - most of these activities fall into the informal sector) and wage employees.

To get an idea of the relative attractiveness of the different occupations, consider Figure 3.8, showing the composition of an average household's income across different occupations in 1998, derived by the author from GLSS4 data. For a sense of proportion, note that the poverty line at that time was 0.7 million cedis *per person*. Seeing that the income of an average food farmer *household* is barely twice that, and that of an average informal sector or cocoa farmer household about three times that, it will come as no surprise that the vast majority of the rural population is poor, and that employment in the informal sector presents only a marginally better alternative.

From Figure 3.7 we see that the share of population in agriculture is sinking, but very slowly. Unfortunately, that decrease goes not go towards the lucrative wage employment in the modern sector, but towards the informal sector which serves as a catch-all. The share of wage employees in the labor force has been stagnating in absolute terms, and thus decreasing in relative terms.

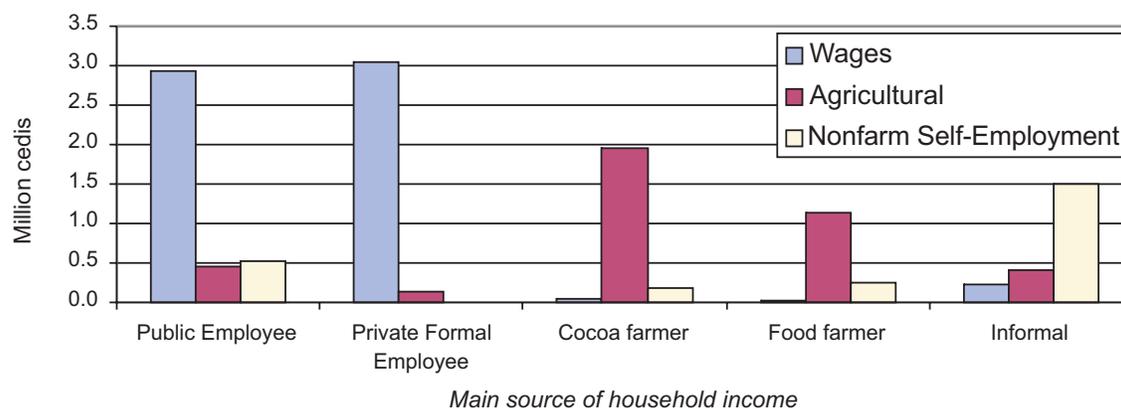


Figure 3.8: *Average Households' Income Composition in 1993 by Main Occupation (author's estimates from GLSS4 data)*

Disaggregating wage employment between government, state enterprises, and private firms (data not shown here) we see that the labor force employed by government has been fairly stable, the labor force employed by the state enterprises has sunk drastically (due to extensive divestiture programs) and increases in employment by private firms have just about made up for that decrease, with no overall growth in absolute terms.

According to Aryeetey and Tarp [2000], the least addressed aspect of fiscal adjustment is its effect on employment, both directly on public employment and through demand effects. Reductions in import duties also had negative impact on domestic employment, and displaced workers mostly landed in the informal sector, further depressing its productivity.

This appears to be a fairly disturbing picture in terms of poverty alleviation prospects. To gain a better understanding for its reasons, let us take a look at the behavior of the different productive sectors.

We do not formulate specific hypotheses concerning the employment composition and income structure of the households. The GLSS surveys are quite rich and fascinating datasets, but unfortunately the detailed investigation thereof is beyond the scope of the present thesis.

3.2.5 Sectoral Behavior

A major goal of most structural adjustment programs is eliminating or reducing what is perceived as price distortions, in particular government subsidies and tariffs. That was also the case in Ghana. This section discusses the sectoral implications.

The sectoral structure of the Ghanaian economy is dominated by agriculture (primarily food for domestic consumption and cocoa for export) followed by a large services sector (some 40% of GDP). The industrial sector is dominated by mining, which is largely foreign owned and has few linkages to the rest of the economy.

The agricultural sector in Ghana is crucial for any poverty reduction strategy, containing as it does over half of the country's working population and having by far the highest poverty incidence. Thus, impacts on the agricultural sector are an important gauge of distributional impacts of a policy.

The impacts of the ERP on the agricultural sector appear to have been mixed. On the one

hand, the initial opening up to foreign trade and the flood of foreign assistance to finance it led to increased availability of capital goods and inputs such as fertilizer; furthermore, the cocoa producers profited from increased producer prices of cocoa and from liberalization of cocoa marketing. On the other hand, the food subsector appears to be weakened by the switch to price incentives for cash crops and by increased cost of fertilizer and labor.

According to Nyanteng and Seini [2000], the level of productivity is generally low due to poor farming practices and very low use of fertilizer, the latter additionally depressed by fertilizer subsidy cuts. Likewise, removal of subsidies on insecticides and fungicides almost tripled their real prices. As government pulled out of procurement, supply and distribution of inputs, private sector did not jump in to fill the gap, resulting in decreased availability.

A major constraint on the marketing of foodstuffs is the poor infrastructure; transportation alone is said to contribute as much as 70% to marketing costs, and storage losses are estimated at between 15% and 30%.

Let us now consider the policies of the ERP that affected the industrial sector. A major component of the program was a package of investment incentives, including unlimited repatriation of profits, a reduction in corporate tax rates, and a shift in price incentives for investment favoring export industries and disadvantageous to formerly protected manufacturing industries.

The main components of the industrial sector are mining, manufacturing (largely for the domestic market), and utilities (largely government-owned). As we have mentioned, mining is mostly foreign-owned and its products are mostly exported. Investment in mining is largely foreign-financed, and thus apart from providing some employment, tax revenue, and modest intermediate input demand, the mining sector appears to be largely insulated from the rest of the economy.

In response to the investment incentives listed above together with generous tax concessions, the mining sector did indeed grow substantially. However, the impacts on domestic manufacturing were largely negative.

Real depreciation and real interest rate raises led to almost a doubling of the cost of capital goods relative to the GDP deflator from 1983 to 1991 [Brownbridge et al. 2000, Table 4.2]. That did not affect mining as it was largely indifferent to domestic price levels, but it combined with the competition from increased imports to depress manufacturing. Average capacity utilization for medium and large factories was between 40% and 46% during 1990-1993 [IMF 1998, Table 12] Apparently, capacity utilization data was no longer collected after 1993.

From this discussion we extract the following testable hypotheses. Firstly, we would expect an increased scarcity of domestic food production, expressed in the increase of its relative price. Secondly, this increase may or may not have been a major driver of overall inflation, as the producer price of crops at the farm gate appears to be a small percentage of retail price of food, due among other things to high transport costs. Thirdly, it would be interesting to know how strongly the composition of output in agriculture and industry (export vs. nontraded) responds to relative price – relative price adjustments being the mainstay of mainstream theory and policy design. Finally, we would like to ask whether industry and manufacturing are primarily demand-driven or supply-constrained. This is important in terms of policy design, as a supply-constrained sector would primarily need capital investment (private or public) to expand its output, regardless of the fiscal policy stance, while a demand-driven sector would be harmed by austerity and benefited by a loose fiscal policy. Note that the answers to the above questions can be different for agriculture and industry.

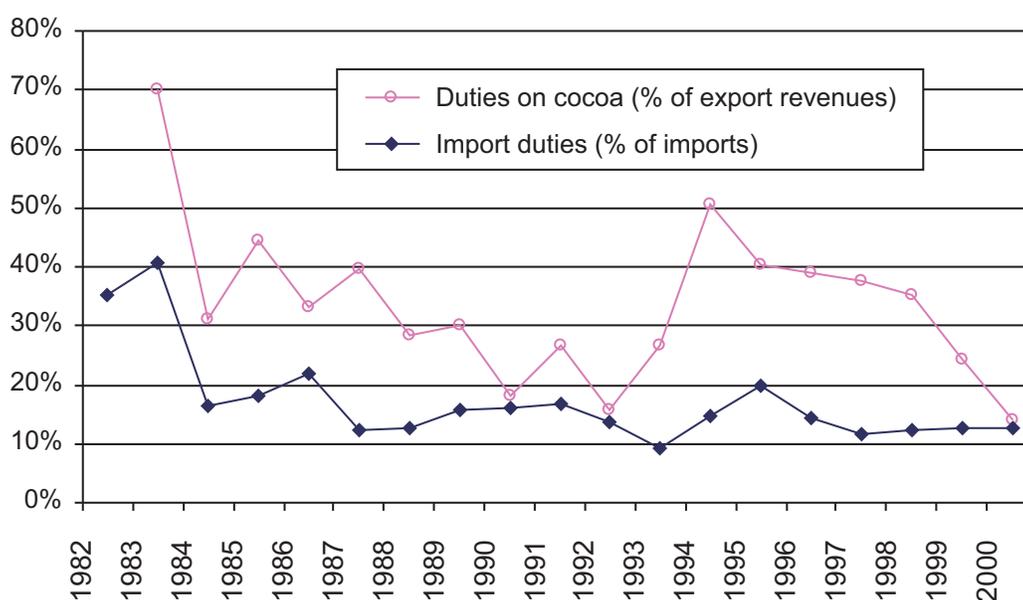


Figure 3.9: *Effective Tariff Rates on Trade (World Development Indicators 2002, Oduro [2000], International Monetary Fund)*

3.2.6 External Trade and Balance of Payments

Another major component of the ERP was to liberalize the trade and payments regime. According to Aryeetey and Harrigan [2000], that had the following goals: narrow the gap between official and parallel exchange rate, provide foreign exchange to ease import strangulation, achieve a viable balance of payments position, clear up arrears, and introduce current account convertibility.

The means to that were devaluations in 1983-86, a foreign exchange auction from 1986, and a free interbank market from 1992 onwards. This was accompanied by a gradual liberalization of imports, with import licenses abolished in 1989 and import tariff rate lowered to between 10% and 30%. Export policies were also gradually liberalized, allowing exporters to retain an increasing share of earnings, reaching 100% in 1991 for all exports except gold and cocoa. The import liberalization programme and the forex auction could only be maintained with the help of foreign transfers [Aryeetey and Harrigan 2000].

Figure 3.9 shows the effective tariff rates on imports and on cocoa exports. The effective tariff rates are computed as the ratio of duties actually collected over the total value of imports resp. exports. The five-year averages of these rates are reported in Table 3.1, which also contains the degree of exchange rate overvaluation (computed from official and parallel exchange rate data in Reinhart and Rogoff [2004]). The tariffs on non-cocoa exports were so low as to be negligible (low single digits). While the tariffs on cocoa are not exactly low, their importance among overall exports is decreasing as the revenue from cocoa exports has been overtaken by both gold and non-traditional exports over the course of the 1990s. What Figure 3.9 and Table 3.1 tell us is that as opposed to tight money and austere fiscal policy (which did not happen), trade liberalization was very much real and sustained. Import tariffs went down and stayed that way, minor fluctuations notwithstanding; exchange rate overvaluation was eradicated by the beginning of the 1990s; and as can be seen in Figure 3.10, both imports and exports were growing as shares of GDP.

Thus, the goals of trade liberalization have been mostly achieved, with the exception of a viable

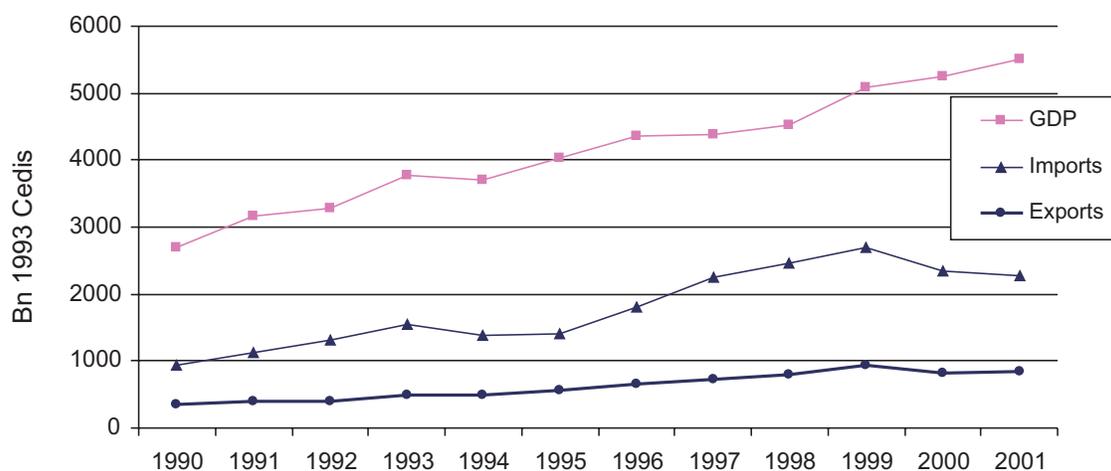


Figure 3.10: *GDP, imports, and exports in real terms (author's estimates, Chapter 7)*

balance of payments position. Looking at the data, we see a continuous nominal depreciation of the exchange rate, approximately (but not exactly) keeping pace with inflation, and a steady increase in volumes of exports and imports, in absolute terms as well as as a share of GDP (Figure 3.10). Although imports and exports grew at about the same rate, the trade balance was always in deficit as the total volume of imports exceeded that of exports by a large margin.

In the early ERP, the overriding objective of trade policy was stimulation of exports. Since 1990s, competing policy objectives have emerged: “Expansionary fiscal and monetary policies have placed pressure on the balance of payments making import liberalization balance of payments incompatible as well as placing pressure on the government budget making import liberalization through reduced tariffs fiscally incompatible” [Oduro 2000].

As a result of the investment surge in mining, gold exports are now ahead of cocoa, but since the former are dominated by transnational firms, the net foreign exchange inflows they generate are comparatively small because of profit repatriation and salaries of expatriate staff [Oduro 2000].

The export-led growth dominated by few primary commodities (cocoa, gold and timber) also made Ghana increasingly vulnerable to fluctuations in international commodity prices. Ghana experienced a double terms of trade shock starting 1999 (Figure 3.11), with cocoa prices low and oil prices high. The results were a further increase in external debt and inflation, as well as a substantial devaluation.

The continuing current account deficits were financed by capital inflows, especially official transfers - leading to a steady increase in external debt from 36.6% of GNP (1982) to 128.3% (2000) (Figure 3.4). While donor assistance was plentiful in the 1980s, the macroeconomic instability in the 1990s (exchange rate instability, rapid money supply growth, inflation, and high government budget deficits) had a negative effect on aid flows [Harrigan and Younger 2000], as a glance on Figure 3.5 will confirm.

Based on this discussion, we would like to ask the following questions: firstly, what are the main drivers of import demand? To be precise, how responsive is import demand to the relative price of imports vs. domestically produced goods, and is there an additional increasing time trend in import demand due to the structural opening up of the economy? (The corresponding question with regard to export supply has already been posed in the previous section). Secondly, it would be very interesting to understand the behavior of the exchange rate and the degree to which it

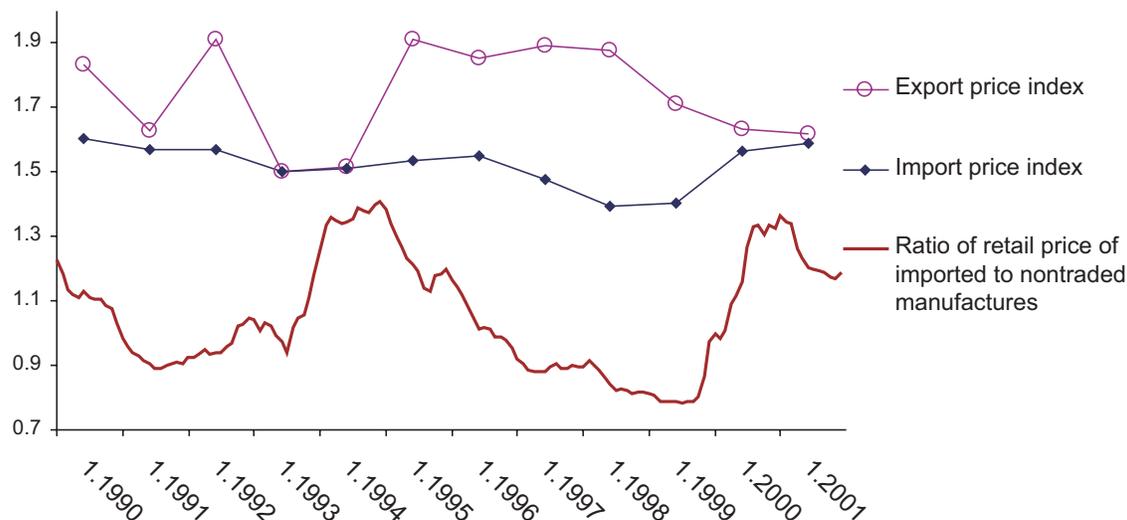


Figure 3.11: *Some Price Indices (IMF Ghana Desk Country Reports and author's estimates)*

interacts with the domestic price level. As Figure 3.11 shows, the exchange rate's behavior was quite volatile, so that prices of imports relative to nontraded goods varied over as much as a factor of two; thus the role of floating exchange rate as the stabilizer for the real exchange rate deserves to be questioned.

3.3 Summary

Ghana is representative of small, open, poor primary commodity producers. In the 1980s, Ghana undertook a radical reform program that largely followed the standard Structural Adjustment blueprint, including elimination of subsidies, opening to trade and capital flows, floating the exchange rate, and combating inflation with high interest rates. In the 1980s, this was accompanied by high foreign exchange inflows, both grants and loans, and the combination resulted in high GDP growth, in particular in the import sector, as well as an accumulation of a large external debt. In the 1990s, the growth rate of the economy diminished, capital formation remained low, current account deficits persisted, and a high inflation rate was combined with periods of "freely falling" exchange rates.

Most structural reforms were concluded by 1991, so that the structure of the economy was comparatively stable during the 1990s. The question of whether the stagnating state of the economy happened because of particular features of the structural adjustment program (such as excess fiscal austerity and high interest rates), or because the latter was not followed consistently enough (meaning mainly too high government deficits), or for other reasons altogether, is far from being settled. Based on the discussion of the literature, we have formulated a number of specific policy-relevant questions and hypotheses that we will attempt to answer in the body of the thesis.