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**Recovery is not
Enough
The Case of Ghana**

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Abstract

The purpose of this teaching case on Ghana is to help seminar participants/students understand one of the few success stories of economic growth in Africa during the 1980s and why it was not sustained in the 1990s. The case has been written to be accessible to both economists and informed noneconomists.

This story concerns first of all Ghana's remarkable recovery, driven by some difficult but fairly straightforward reforms. It then goes on to explore the sources of the recovery and the underlying reasons why the growth rate began to falter, instead of rising to the levels necessary for significant, long-term poverty reduction. Special attention is paid to savings and investment and the roles of the public and private sectors in this regard. This case is also of interest because it takes place in a society emerging from crisis and evolving from authoritarian to democratic rule, two characteristics common to African countries.

Although Ghana was often touted as the African structural adjustment success story of the 1980s, this case is not intended to justify World Bank/International Monetary Fund (IMF) adjustment lending. It does represent an interesting example of both the strengths and weaknesses of one reform process without pretending to assign credit or blame.

A set of teaching notes for instruction is available separately.

Recovery is not Enough: The Case of Ghana

President Jerry John Rawlings was frustrated once again. Here it was, 1994, thirteen years after he had seized power, and many people were still complaining that they had seen little if any improvement in their lives. The Bank of Ghana reported that the economy had been growing at an average of 5 percent a year during his regime, which was a radical change from the 1970s and certainly better than any of the neighboring countries. But, frankly, he had expected to see a bigger difference in people's lives by now—and less criticism.

Of course, part of the problem was that some people still remembered the good old days. Ghana was one of the first sub-Saharan African states to achieve independence and for good reason. It was arguably the most developed country in the region and had one of the best education systems and an internationally respected leader. At the time, its per capita income put it on a par with South Korea. This success had been built on rapid expansion of smallholder cocoa production, which had made Ghana the world's largest cocoa exporter by 1960.

From this auspicious beginning, Ghana had proceeded to set new records of a different sort. Few countries have experienced such a dramatic decline in their well-being without suffering through a war. But poor government policy combined with an unstable political regime began gradually to undermine the foundations of Ghana's economy and indeed its society. State intervention resulted in unsustainable levels of public expenditure, while discouraging private initiative, most notably in the critical cocoa sector. Inflation worsened as tax revenues diminished and the government financed its spending through increases in the money supply. Failure to let exchange rate adjustments compensate for high domestic inflation led to foreign exchange shortages and a black market for the little that was available. Smuggling flourished.

By 1979 the country was in a mess. Ordinary people were dying of starvation, while a few exploited their privileged positions to live in fine style. Furthermore, this elite financed its lavish consumption through illegal and immoral means. By their example and because of their mismanagement of the economy, others had to resort to similar behavior just to survive. Corruption was rampant, even in Rawlings' own Armed Forces.

Rawlings Takes Charge

Rawlings had been really angry back then. He had decided that the government needed a good hard slap, so, on May 15, 1979, he led a coup attempt. This failed and he was arrested, but on June 4 his supporters undertook a second successful coup, whereupon he was released and made chairman of the ruling junta. Because he did not really want the job of running the country, he soon handed power back to a new, democratically elected government. Unfortunately, they proved incapable of changing the situation, so, on December 31, 1981, he regained control—and settled in to do it himself.

He had certainly changed since those early days. Everyone becomes more conservative as they age, but he was a real radical when he first took power. "I ask for nothing less than a

revolution, something that would transform the social and economic power of the country,” he had said.¹ “People’s tribunals,” which could overrule the traditional judiciary, had been established to root out corruption. People’s and workers’ defense committees had been set up to shift power to the grassroots, including elimination of “anti-revolutionary practices.”

On the economic front, his ideas had been less clear and his actions less dramatic. He had talked about foreign dependence and exploitation but traced this back to domestic mismanagement. He regretted the proliferation of traders and offered “People’s Shops” run by defense committees as an alternative; however, he did not repeat the razing of markets that had marked his brief 1979 regime. Instead, he argued that the failure to encourage domestic production in both agriculture and industry had driven everyone into buying and selling. The old government had wasted its time crisscrossing the globe in search of foreign aid and investors, whereas Ghana’s own foreign exchange earner—cocoa—could not even get to the port. He had urged the defense committees to promote productivity among farmers and industrial workers and promised that the government would pursue financial discipline.

He had thought that there would be an active role for both government and his labor supporters. Rent and price controls had been introduced, employees laid off by previous administrations were reinstated, and a freeze on further layoffs was declared. Labor was given a major role in managing various organizations and actually took over two of them. He had even proposed a state monopoly of the import/export business to halt the needless drain of foreign exchange and redirect trade toward new, socialist partners. He smiled now as he contrasted those ideas with his subsequent actions.

Economic Performance and Policy Reform

During the 1960s, national output (GDP) had grown fairly continuously but barely enough to keep up with the expanding population. During the 1970s, GDP stagnated leading to declining real income per capita. Then the economy went into a free fall (see graph in annex 1). GDP dropped an average of 3 percent per year between 1979 and 1982. Food shortages became so severe that even senior civil servants in Accra were having trouble finding enough to feed their families. For the vast majority of Ghanaians it had become impossible to provide education or medical services for their children. The minimum wage had lost 62 percent of its value since 1970; the purchasing power of an average Ghanaian’s earnings had fallen by one-third.

The economy hit bottom in 1983 with the worst drought in memory. Fires burned one-third of the cocoa area leading to the lowest harvest since independence—and only 40 percent of the average level achieved in the early 1960s. The main hydroelectric facility at Akosombo Dam ran out of water, creating power shortages and firm closures. Then as many as one million Ghanaians were expelled from Nigeria and had to be absorbed back home. Meanwhile, Rawlings’ radical populist approach had created an atmosphere of social upheaval. Some had compared it to Mao’s Cultural Revolution, but Rawlings considered that a bit of an exaggeration.

During the first year of his regime, a heated debate was carried out between his radical supporters and more mainstream economic advisors. With the continued decline in the economy (and no significant assistance from Libya), the latter group was given the opportunity

¹ Folson (1993), p. 79.

to try their approach including discussions with the International Monetary Fund (IMF). In April 1983 a new budget was announced along with a devaluation of the local currency, the *cedi*. The accompanying package of reforms was to become known as the Economic Recovery Program (ERP). It represented a major reversal in the policies of the first fifteen months, as well as the statist alternative of his predecessors. Broadly speaking, it reflected the market-based, outward-oriented approach of the IMF and the World Bank, albeit with some strong local advocates.

The main objectives of the ERP were fairly typical:

- To “get the prices right” by devaluing the exchange rate, increasing real interest rates, and decontrolling internal prices
- To reduce the fiscal deficit sufficiently to eliminate the need for printing money to cover it, thus, reducing inflation
- To liberalize the economy, including the foreign sector, by encouraging markets to function freely.

Devaluation was a particularly sensitive topic in Ghana; a previous regime had been overturned because of public opposition to just such a move. Local economists, however, eventually convinced Rawlings that a devaluation would be one of the best ways to stop the corruption, smuggling, and profiteering that so incensed him. It could eliminate the need for foreign exchange controls and import licenses, which had enabled well-connected friends of previous regimes to get rich even as the economy deteriorated. It would also permit the payment of higher prices to cocoa farmers, because the Cocoa Marketing Board would get more *cedis* for each kilo of cocoa exported. At least some average Ghanaians would, thus, immediately benefit.

Rawlings had also been preoccupied from the beginning with the mismanagement of the economy. Two obvious indications were rampant inflation and a large government deficit. If the two were somehow connected, as the economists argued, that was all the more reason to tackle them both. Furthermore, he easily accepted the idea of raising taxes on the elite as one way to increase revenues, because everyone knew that the rich tended to avoid taxes, whereas farmers and other ordinary Ghanaians had no choice but to pay.

He had somewhat more of a problem with the proposal to encourage domestic markets and increase Ghana’s integration into the world economy. Why, only a year before, the preface of his government’s Revised Budget Statement had said that the crisis resulted from “the inevitable working of the pattern of international economic relations controlled by a concentration of integrated multinational corporations in industry, working hand in hand with transnational banks.”² And one of the effects was relatively well-off “parasites in trade distribution.”

He had been deeply concerned, however, about the plight of the productive members of society, by which he meant farmers and workers. His economic advisors insisted that liberalized prices were essential to ensuring that producers were properly rewarded for their labor. They also argued that their prescriptions would generate a larger volume and variety of exports. Rawlings recognized the need for a certain amount of foreign exchange, and he liked the idea of reducing the country’s historic dependence on cocoa exports through diversification.

²Folson (1993), p. 83.

Economic Rebound: 1984–87

The immediate response of the Ghanaian economy to the new policy environment was overwhelmed by the drought of 1983, so GDP continued to fall in that year. The subsequent recovery, however, was impressive. Total national output not only expanded for the first time in four years, GDP growth of 8.6 percent in 1984 more than made up for the losses of the previous year. Growth continued at 5 percent for the next three years.

This was a period of economic rebound, much as a dropped ball bounces back. Furthermore, moderately improving export prices, a fall in the price of imported oil in 1985, and the resumption of significant aid inflows aided Ghana. With the help of the devaluation of the *cedi*, which dramatically increased the value of cocoa exports in local currency, the government had offered steadily increasing prices to cocoa producers. Producers responded both by increasing their production and by reducing smuggling to neighboring countries where prices had previously been more attractive. As a result, the value of cocoa exports doubled between 1983 and 1986. Government revenues expanded and so did incomes of cocoa farmers.

The renewed availability of foreign exchange from exports and foreign aid meant that manufacturing and transport could once again obtain spare parts and other imported inputs. Together with the recovery in demand, this permitted an expansion of capacity utilization. Firms that had been only running at 10 percent of their capacity were soon back to levels of 50 percent. Traditional exports, such as timber and electricity, also returned to more typical levels. The marked increase in both exports and imports contributed to a rapid expansion in domestic transportation, wholesaling, and retailing.

By 1986 the economy had recovered to the level of total output achieved in 1979. This, however, was partly due to a simple expansion in population—more farmers and small-scale entrepreneurs and traders were producing more goods and services simply to survive. Per capita incomes were still below the level in 1975. The volume of key exports remained at or below levels achieved in the mid-1970s (see table 1). The economy was at last headed in the right direction, but it had only just begun the journey.

Table 1. Evolution in the Volume of Key Exports: 1970–1992

	Cocoa (thousands of tons)	Gold (thousands of ounces)	Timber (thousands of cubic meters)
1970	441	632	354
1976	394	525	450
1980	296	346	150
1983	178	278	180
1987	228	324	497
1990	261	526	373
1992	243	995	407

Source: Bank of Ghana, *Annual Report*, various years.

Rebuilding: 1988–92

The honeymoon ended in 1988 as the easiest phase of cocoa expansion was finished. Further growth in production required investment in new trees, but at this point international prices began a steady decline. If the price to cocoa farmers was to be maintained, savings would have to be made in the cost of marketing their output through the huge Cocoa Marketing Board (CMB). With 100,000 employees, some improved efficiency and downsizing was possible, but that would still entail some short-term economic and social costs in the form of severance packages, retraining, and unemployment. Cocoa production rose until 1988, after which it stabilized at around 300,000 metric tons, still well below levels achieved in the 1960s and early 1970s. Employment in the sector gradually fell with the downsizing of the CMB.

Timber exports also leveled off after 1988, as concerns developed on the pace of deforestation and the resulting environmental implications. Nor was there much potential for further exports of electricity. A few nontraditional exports responded well to the new policy climate. Processed wood products quadrupled in value between 1989 and 1993, and horticultural exports tripled. Although this began the important process of diversifying the export base, the impact on total earnings and national output remained modest.

Fortunately, plenty of room still existed for growth in gold production, because its recovery was only beginning. These operations demanded immediate and sizeable investments before any expansion could take place, so in 1986 output was still below 1982 levels and half that of 1974. But, during the next six years, output quadrupled so that gold exports surpassed those of cocoa to become the most important foreign exchange earner. The improved policy environment, including a relatively stable and realistic exchange rate and the sale of government shares in state-owned mining companies, had attracted considerable foreign investment.

The other major new source of foreign exchange was foreign aid. As the Ghanaian government demonstrated its capacity to stick with the adjustment program, new donors were attracted and old ones expanded their involvement. Official grants, thus, doubled between 1985 and 1990, while long-term loans trebled. Private grants also trebled during this period, as overseas Ghanaians and foreign NGOs took greater interest in the revived economy. These grants reached dollar amounts equivalent to those of official donations. The combination of the three types of capital inflows—official aid, long-term loans, and private transfers—equaled 80 percent of all merchandise exports and 9 percent of GDP. On the other hand, foreign direct investment did not show significant growth.

As a result, imports were able to grow even faster than exports, while both grew faster than the economy as a whole. Together, imports and exports as a share of GDP doubled from 18 percent in 1984 to 37 percent in 1992. This translated into increased activity for domestic transport, wholesaling, and retailing, which consistently outpaced the overall economy.

Two other strong sectors were construction and government services, stimulated to varying degrees by foreign aid, export revenues, and private transfers. Although structural adjustment programs are well known for their attempts to reduce the size of government, this did not happen in Ghana. Most of the aid went to or through the government in one form or another. Expanding trade also generated needed tax revenue. Indeed, government services had been so depleted by years of economic decline that it was essential to expand some programs—and increase salaries. Average real earnings in the public sector tripled between 1983 and 1988. Education,

health, and infrastructure were in desperate shape. Efforts were made to reduce the size of the civil service to a level commensurate with that of the economy, but the government sector, as measured by its operating budget, grew at roughly the same pace as the economy at large.

On the other hand, the two largest sectors—agriculture and manufacturing—were dragging behind the rest of the economy rather than leading it. Agriculture, accounting for half of the entire GDP, was growing at only 2 percent per year. This was not even equal to the rate of population growth (roughly 3 percent per year). The government's focus on cocoa had been partially thwarted by the decline in international prices. Meanwhile, the rest of the sector had been somewhat neglected. For example, although cocoa represented 15 percent of total agricultural GDP, it received 80 percent of public expenditures on extension.³

Manufacturing, another 10 percent of the economy, was struggling merely to keep up with the rate of population increase. Capacity utilization among medium- and large-scale enterprises stagnated at only 40 percent, suggesting that old machinery suffering from years of neglect was no longer capable of achieving the output levels at which they had been originally rated. Further expansion would, therefore, require new investment. Small entrepreneurs were appearing but their impact on total output remained modest. Older, larger companies were slow to make new investments. They complained about competition from small enterprises, as well as from imports, as trade liberalization proceeded. Both groups cited lack of credit and the high cost of what was available. As the economy liberalized to confront the rigors of international competition, considerable restructuring was taking place. Although some subsectors were doing well (such as cement and beverages), others were no longer viable in the new, less protected economy.

Some large enterprises were state-owned ones, which discouraged private entrepreneurs from entering their sectors, either because these enterprises had been granted a legal monopoly or because they enjoyed public subsidies not available to private competitors. Their preferential access to bank credit also reduced the amount available for others. Although some 300 public enterprises were identified for divestiture, progress was slow. The government was not convinced of the necessity to privatize—not surprising given its earlier preference for an active role for the state. The social and political implications of the inevitable labor retrenchment only reinforced this reluctance.

Ghana's growth experience from 1984 to 1992 is summarized in table 2. After the rebound of 1984, all sectors except agriculture maintained healthy growth rates for the next three years. Thereafter, manufacturing also slowed and the expansion was maintained by other industry (mining, construction, and utilities) and services. But with half of the economy still accounted for by agriculture, it was not possible to raise the national average growth rate above 5 percent without better performance in this sector.

³ Alderman and Shively 1996, p. 62.

Table 2. Sectoral Growth Experience: 1984–92
(percent)

	Share of GDP	Annual growth rates		
		1984	1985–87	1988–92
Agriculture	48	9.7	1.3	2.0
Manufacturing	9	12.8	15.1	3.1
Other Industry	7	3.6	7.0	8.9
Services	36	6.6	7.4	7.0
Total GDP	100	8.6	5.0	4.6

Source: World Bank, 1989, "Ghana: Structural Adjustment for Growth," p. 121. World Bank, 1991, "Ghana: Progress on Adjustment," p. 71. World Bank, 1995, "Ghana: Growth, Private Sector, and Poverty Reduction," p. 95.

A Question of Saving and Investment

Sometimes output can expand on the basis of existing productive capacity with a little more work, stronger demand, better weather, or more foreign exchange. By tending their trees more carefully and harvesting more thoroughly, cocoa farmers can increase production. Underutilized factories need only an increase in demand and/or foreign exchange for some imported raw materials to raise their level of output. Transporters who already have some trucks can keep them running with a few spare parts. Wholesaling and retailing can expand using existing storage and shop space. Akosombo Dam needed little more than a few normal rainy seasons after the drought of 1983 to fill its reservoir and return its electricity generation to historic levels.

Eventually, however, new investments are required. Cocoa trees more than thirty years old should be replaced. Better storage facilities are needed, especially for perishable foodstuffs, so that larger harvests do not flood the market but can be preserved for the off-season. Old trucks must be replaced and new ones purchased to cope with the rising flow of exports to the ports and consumer goods and inputs to rural areas. Established factories must replace their machinery, new ones must acquire plant and equipment. Ghana is blessed with diamond, bauxite, and manganese deposits as well as gold, but mining is particularly capital intensive so the rehabilitation and expansion of this sector requires huge investments. Even wholesalers must eventually enlarge and modernize their warehouses.

Although most of these costs fall on private individuals, the public sector must also be involved. Roads had deteriorated to such an extent in Ghana that the northern part of the country was virtually inaccessible. The railway and ports were in desperate need of renovation. It would take until the year 2000 before the transportation network could be restored to the status prevailing in 1970. Water, electrical, and telephone utilities demanded immediate attention, both to meet the needs of the population and to ensure reliable service for private operators. The country's "human capital" had also been neglected, even as the population grew. New schools had to be built and furnished with teaching materials and new health clinics established. Investments in plant and machinery would be of little use without complementary expenditures on the work force.

As table 3 indicates, the share of national output allocated to investment (as opposed to consumption) gradually grew from the dismal level of the early 1980s. Public investment

responded first, as one would expect given the greater willingness of the government to take risks and its easier access to foreign aid. The private sector was slower to increase its investments, but by 1991 the share of GDP accounted for by private investment, both foreign and domestic, had almost doubled over the 1984 level. The rate of investment (15.8 percent of GDP), however, was still not much above the level achieved in 1975. Furthermore, by 1992 private investment had fallen off, so that public investment once again dominated.

Table 3. Evolution of Investment: 1975–93
(percent of GDP)

	<i>Public</i>	<i>Private</i>	<i>Total</i>
1975	10.7	2.1	12.7
1980–83	1.4	3.1	4.5
1984	2.5	4.4	6.9
1985	4.2	5.4	9.6
1986	7.3	2.1	9.4
1987	7.9	2.5	10.4
1988	8.0	3.3	11.3
1989	7.8	5.5	13.3
1990	6.8	7.6	14.4
1991	7.7	8.1	15.8
1992	8.5	4.3	12.8
1993	9.9	4.9	14.8

Source: World Bank, 1995, "Ghana: Growth, Private Sector, and Poverty Reduction," p. 89. IMF, 1995, "Ghana: Background Information on Output and Investment Performance," p. 54.

These major expenditures have to be financed in one of three ways—foreign savings (aid or private capital), private savings, and public (government) savings. Foreign aid can play an important role, and it has, particularly in the area of infrastructure, which accounted for 62 percent of the public investment program in 1990–92. As shown in table 4, foreign savings have risen sharply from the negligible levels of 1975–83.

The government has also managed to generate some savings by ensuring that tax revenues grew faster than the current expenditures required to keep its programs and services operating. These savings were nonexistent in the early 1980s, but they grew to 3 percent of GDP by 1991 (table 4). Private savings have been somewhat higher than public savings, fluctuating between 3 and 6 percent of GDP. Domestic public and private savings together had been revived to a level equaling 9.3 percent of GDP by 1991. Nonetheless, this still compared poorly to the average for sub-Saharan Africa (16 percent), even before the dramatic fall of such savings in Ghana in the next two years. By 1993 foreign savings accounted for almost all saving and investment. What had happened?

Table 4. Evolution of Savings: 1975–93
(percent of GDP)

	<i>Public</i>	<i>Private</i>	<i>Foreign</i>	<i>Total</i>
1975	-2.2	14.9	–	12.7
1980–83	-4.4	8.3	0.6	4.5
1984	-0.6	4.6	2.9	6.9
1985	0.1	5.3	4.2	9.6
1986	1.7	3.4	4.3	9.4
1987	2.9	2.7	4.8	10.4
1988	2.7	3.5	5.9	11.3
1989	2.5	4.7	6.1	13.3
1990	1.8	5.6	7.0	14.4
1991	3.2	6.1	6.5	15.8
1992	-2.2	6.0	8.6	12.8
1993	-0.9	2.3	13.4	14.8

Source: World Bank, 1995, "Ghana: Growth, Private Sector, and Poverty Reduction," p. 89. IMF, 1995, "Ghana: Background Information on Output and Investment Performance," p. 54.

1992: Budget Meets Ballot Box

As Dickens said, it was the best of times and it was the worst of times. Presidential elections were to be held in November—the first time since Rawlings seized power. Repeated unsuccessful coup attempts by his opponents had subsided, and various political reforms had been introduced. With the continued expansion of the economy, Rawlings had earned significant support among some groups, notably in the rural areas. So he had been ready to test his popularity at the polls, while Ghanaians had been eager to return to the democratic process to which they had become accustomed, in spite of its blemishes.

At the same time, "adjustment fatigue" was settling in, especially in Accra. The process was taking longer than many had expected, and the pace of improvement had slowed since the early days of recovery. Indeed, poverty seemed to be increasing in the capital city (see annex 2). The structural adjustment program was, as its name implied, trying to change the structure of the economy, most notably by limiting the size of the large public sector and relying more on private enterprise. After some initial increases in public sector wages, the focus had shifted to nonwage expenditures, capital investments, and reductions in the number of employees in both the civil service and state-owned enterprises. Inflation, which averaged 37 percent in 1990 and 18 percent in 1991, had eroded the wage increases granted over the last two years. The public sector employees concentrated in Accra, however, were particularly disgruntled; doctors, nurses, Ghana Cocoa Board workers, and railway employees called strikes in May, June, July, and September, respectively. Then, the civil service went on strike.

With elections only two months away, Rawlings and his government had started to worry. They approved an 80 percent pay raise for civil servants, retroactive to July, as well as smaller increases in pensions and in wages in subsidized public organizations. As this coincided with a shortfall in government revenues, government borrowing rose dramatically to help finance these unanticipated expenditures. Consequently, wages and salaries, subsidies and transfers, and interest payments climbed from 7.9 percent of GDP in 1991 to 10.1 percent in 1992 and 12.7 percent in 1993. With operating expenditures now exceeding revenues, public savings turned negative, as shown in table 4.

The impact of this sharp reversal in fiscal policy was also felt in the private sector. Still harboring some doubts about the direction of government policy and the role envisaged for private enterprise, it now had to review its assumptions about the stability of macroeconomic policy. Indeed, inflation shot up from 10 percent in 1992 to 25 percent the following year as higher wages were spent on domestic goods and services. Higher public borrowing and concern about restraining inflation drove up nominal interest rates from 19 percent to 30 percent. With the increased cost of borrowing and the general economic uncertainty, investors became more cautious and private investment fell back to 4.3 percent of GDP. Private savings were slower to react, but they too fell off in 1993.

The Predicament

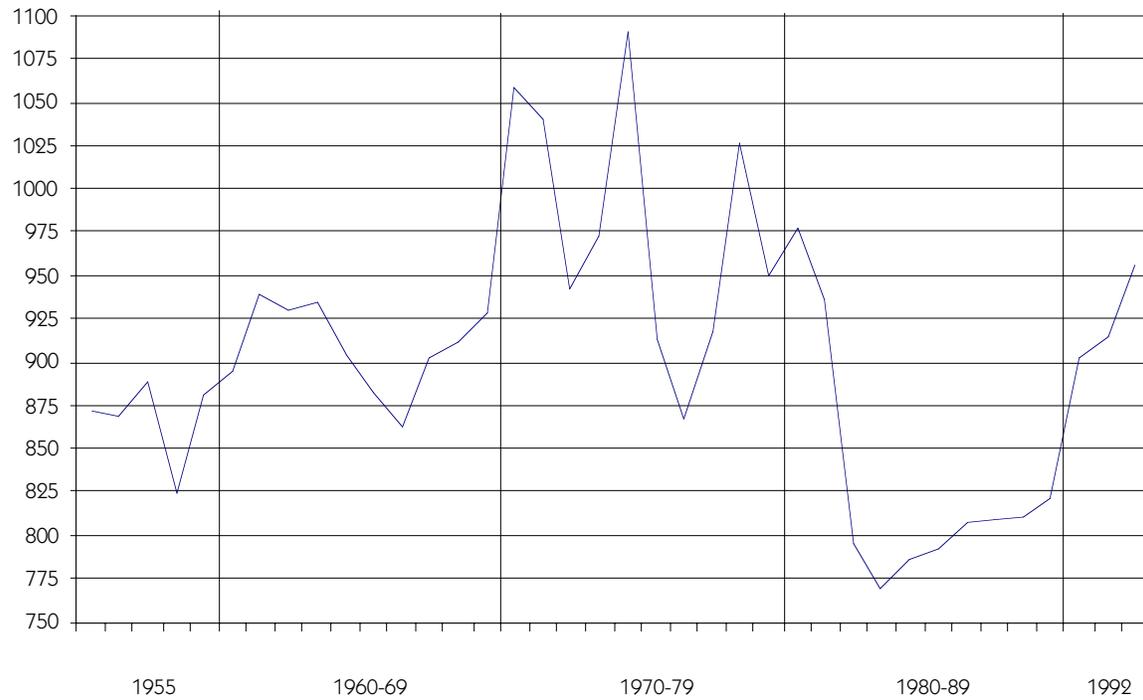
So here it was 1994. Rawlings had won the election but now he had to resume management of the economy in a democratic environment with an empowered legislature and a freer press. The growth rate of national GDP had fallen below 4.0 percent for the second time in three years. With the population still expanding by 3 percent annually, it was going to take a long time to eliminate poverty. Indeed, poverty was actually increasing in Accra. The government's privatization program was finally starting to take hold, much to the chagrin of public sector employees. With inflation back up to 25 percent and rising, the 1992 wage gains of organized labor were being eroded. They would soon be demanding another increase. Yet tax revenues had already grown to 16 percent of GDP (up from 6.6 percent in 1984), and there was little room for further tax hikes without having a discouraging impact on the private sector.

Something needed to be done to raise the growth rate in order to generate new jobs and enable both higher consumption to meet today's needs and greater savings for investments in tomorrow. Dependence on foreign aid was becoming disproportionate. Fourteen years after coming to power, Rawlings was being criticized in the same way he had accused his predecessors—looking to foreign donors to solve his problems instead of drawing on Ghanaian resources. And, once again, traders seemed to be prospering, whereas farmers and workers were struggling.

But what could he do differently? Why was it proving so difficult to maintain GDP growth at even 5.0 percent? What could he do to strengthen the rate of growth?

Annex 1

Annex Table1. Ghana: Income Per Capita, 1955–92
(Purchasing power parity estimates of GDP per capita in 1985 US dollars)



Source: Penn World Tables, Mark 5.6, www.nber.org/pwt56.html

Annex 2

Annex Table 2. Changes in the Incidence of Poverty over Time
(percent)

	Incidence of Poverty		Share of Population ^a
	1987–88	1991–92	
National	37	32	100
Rural	42	34	66
Urban	27	27	33
Within urban			
Accra	9	23	8
Other	33	28	25
Within rural households			
Nonfarm	40	29	20
Noncocoa farmers	43	37	41
Cocoa farmers ^b	43	32	5
By gender			
Male-headed	36	33	63
Female-headed	39	29	37

a. Average of shares in the two time periods.

b. Farm households receiving more than 50 percent of crop revenue from cocoa.

Source: World Bank, "Ghana: Growth, Private Sector, and Poverty Reduction," *Country Economic Memorandum*, May 15, 1995, pp. 27–29.

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**Recovery is not
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Teaching Notes

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Recovery is not Enough
The Case of Ghana

Teaching Notes
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Abstract

The purpose of this teaching case on Ghana is to help seminar participants/students understand one of the few success stories of economic growth in Africa during the 1980s and why it was not sustained in the 1990s. The case has been written to be accessible to both economists and informed noneconomists.

This story concerns first of all Ghana's remarkable recovery, driven by some difficult but fairly straightforward reforms. It then goes on to explore the sources of the recovery and the underlying reasons why the growth rate began to falter, instead of rising to the levels necessary for significant, long-term poverty reduction. Special attention is paid to savings and investment and the roles of the public and private sectors in this regard. This case is also of interest because it takes place in a society emerging from crisis and evolving from authoritarian to democratic rule, two characteristics common to African countries.

Although Ghana was often touted as the African structural adjustment success story of the 1980s, this case is not intended to justify World Bank/International Monetary Fund (IMF) adjustment lending. It does represent an interesting example of both the strengths and weaknesses of one reform process without pretending to assign credit or blame.

Recovery is not Enough: The Case of Ghana Teaching Notes

This case offers two sets of lessons:

- Sources of success: what Ghana has done right to return to a growing economy
- Causes for concern: why Ghana is still struggling

Once the group has sorted out these issues, discussion should try to come up with some recommendations on how to promote future growth.

Sources of Success

1. *Recovery from crisis.* For many years, Ghana was really enjoying nothing more than a rebound to more normal conditions. In addition to improved weather, government economic policy became more stable and constructive. Inflation decreased, thereby encouraging private investment and savings. Government tax revenues expanded, enabling an increase in public sector wages, the timely payment of private suppliers, and less upward pressure on interest rates through public borrowing. The exchange rate was devalued to reflect a truer value of the *cedi*, thus promoting exports and raising the availability of foreign exchange for essential imports.
2. *Fiscal discipline.* The government went a step further to eliminate the deficit on recurrent expenditures, generating public savings that could be invested in infrastructure, schools, and hospitals.
3. *Export promotion.* In addition to the devaluation, other measures were taken to encourage exports. The benefits of the devaluation were passed on to cocoa farmers through sharply higher producer prices. Foreign private investment was encouraged in gold mining. Better roads and ports aided all export sectors. Such policies enabled a partial recovery in cocoa and timber and eventually the achievement of record output levels in the case of gold.
4. *Foreign capital.* This return to normalcy brought back foreign aid and a certain level of private flows from overseas Ghanaians; thus, foreign exchange availability improved further as did investment and government revenues. Domestic construction and the service sector—transport, wholesaling and retailing, and government services—boomed.

Causes for Concern

The growth enjoyed by Ghana between 1984 and 1992, even though it lasted eight years, was still tenuous, reflecting a recovery from years of mismanagement rather than a new path of sustainable development. Indeed, the continued success in attaining the target growth rate of 5 percent a year for most of the period may have created a sense of complacency. In fact, many warning signs should have been heeded.

1. *Export performance.* It is difficult for a small economy to grow quickly without taking advantage of the international market by rapidly expanding exports. Exports did expand significantly, but only in the case of gold were historic levels surpassed, and, in both cocoa and timber, the long-term potential was limited. Cocoa faced stagnant international demand and falling world prices; timber was confronted by important environmental constraints.
2. *Service dependence.* Growth depended too much on the service sector, which in turn depended on expanding imports, government activity, and foreign aid. It was not in itself a source of foreign exchange (e.g., through tourism, shipping, or offshore banking).
3. *Industrial weakness.* Although mining was doing well, manufacturing—the largest component of the industrial sector—was not. After an initial rebound, the sector had trouble competing with imports or expanding exports.
4. *Sluggish agriculture.* This sector, which still employed half the population, was growing only slowly. The GDP of an agriculturally based economy is unlikely to grow at more than 5 percent a year when agriculture is only growing at 2 percent. Furthermore, the growth that was occurring was largely concentrated in the cocoa sector. Cocoa rehabilitation was an important first step in getting the economy back on its feet, because so much underutilized capacity existed that could be easily exploited; yet, it was only a first step.
5. *Inadequate private sector response.* Sustainable growth requires both a strong public sector and a dynamic private one. Private investment rose slowly for a while but by 1992 it was back to where it had been in 1984. This constrained the level of total investment to modest amounts (12–15 percent of GDP) and put excessive reliance on public investment, which in turn depended on foreign aid. East Asian experience suggests that, for sustained high growth, much higher overall rates of investment are needed (20 percent in 1965 and 35 percent today), two-thirds of which came from the inherently more sustainable private sector.
6. *Macroeconomic instability.* Perhaps the biggest problem arose in 1992 with the “fiscal shock” that resulted from a sudden increase in public spending. This had an immediate negative effect on public investment by eliminating public savings. It also had a direct impact on the private sector because of the rise in inflation and interest rates. The most serious result, however, may have been psychological, that is, its effect on investor confidence. This policy reversal demonstrated to both domestic and foreign private investors that government economic policy remained unreliable and was still unable to balance the tradeoffs between short-term political considerations and long-term economic concerns. It was a major setback for private confidence in the policy environment, which had been slowly returning after years of mismanagement under previous regimes and the early interventions of the Rawlings regime.

(The explanation for the fall in private savings is less clear but probably related to increased uncertainty and declining investment. Note, however, that the data itself are unreliable because private savings are simply calculated as a residual. With investment roughly constant, a big rise in foreign savings, and a small decline in public savings, private savings also had to fall for things to balance out.)

Recommendations

7. *Fiscal discipline.* Avoid further shocks in public spending, and return to a surplus in the operating budget. This will help restore private sector confidence (both domestic and foreign), control public sector borrowing and increases in the money supply, and generate savings for the public investment program.
8. *Promote the private sector.* Provide clear signals that the government wants a strong private sector. In addition to number one, this would involve both public statements to this effect and concrete actions such as (a) streamlining government regulations and procedures (licensing for new enterprises, clearing customs, and tax collection), (b) promoting foreign investment (perhaps with a preference for joint ventures), (c) limiting government demands on public savings, (d) withdrawing from some sectors through privatization, and (e) establishing mechanisms to ensure a regular dialogue between the state and the private sector.
9. *Encourage agricultural growth.* Devote more public resources to noncocoa production and facilitate private investment in agriculture. This might include more attention to public research and extension and the maintenance and construction of rural roads, as well as the expansion of rural banking and insurance. As in the rest of the economy, restricting government actions to areas in which it is clearly more competent than the private sector (that is, obvious public goods) will be important.
10. *Diversify the export base.* Although some diversification has been achieved, more is needed given the inherent limitations of cocoa and timber, in particular. Other agricultural exports will benefit from the actions included under number three. Other mineral exports could be developed with the help of more foreign investment. Manufactured exports will eventually be needed as well, although it is important to stress that a resource-rich country such as Ghana will not depend as much on this sector as the East Asian countries have. Wood products and clothing are two likely categories.
11. *Raise domestic savings.* If growth is to be sustainable, Ghana will have to reduce its dependence on foreign aid by mobilizing domestic resources. This will require both a certain level of public savings and especially higher private savings. The latter will depend on a more developed and less risky financial sector, a more stable macroeconomic environment, and probably a better private investment climate. Steady economic growth will also facilitate higher savings, so the combination of all the actions listed here can create a “virtuous circle of prosperity.”

The Social Impact of Adjustment and Growth

Although best treated in a separate session, some discussion of “who really benefits?” is often impossible to avoid. This is particularly true when working with groups drawn from civil society; however, economists should also be concerned about the quality of growth. Although data problems are notorious in this area, some recent information on the evolution of household living standards in Ghana is now available, presented in annex 2.

Data is only available for the years 1987–88 and 1991–92, so the immediate recovery period of 1983–87 is missed; thus, the extent of poverty reduction is certainly underestimated. Focusing on this later period, however, helps distinguish between the benefits of a simple return to more normal conditions, including good weather, and the effect of the different policy environment. In any event, the incomes of the poor appear to have significantly improved with some interesting variations across different groups.

The share of all households falling below the poverty line has dropped from 37 to 32 percent, with the biggest gains in rural areas. Urban areas have also benefited, with the notable exception of Accra. In the capital, poverty seems to have increased significantly, even though the level remains below that of the rest of the country. This is probably explained by the contraction of the parastatal sector and, to a lesser extent, some large, modern enterprises, both of which tend to be concentrated in Accra. (This means that the casual foreign observer who makes occasional trips to Accra might well come away with the impression that things have not improved for the “ordinary Ghanaian.”)

Changes in rural areas have been especially dramatic. These changes have not been confined to cocoa farmers or to male-headed households; indeed, nonfarm households and those headed by women have made the biggest gains. Although various factors are at play here, probably the most important is the boom in the service sector and especially trading. Female-headed households are twice as likely to be involved in nonfarm self-employment so they have gained more from this boom.

These results also reveal good news on the degree of inequality in Ghana. The distribution of benefits from growth, although not improving income inequality, has at least not exacerbated it. Paying more attention to noncocoa agriculture in the future would favor the group that has experienced the smallest improvement and now has the highest incidence of poverty.