

Findings



Africa Region . Number 52 . November 1995

Findings reports on ongoing operational, economic and sector work carried out by the World Bank and its member governments in the Africa Region. It is published periodically by the Africa Technical Department on behalf of the Region.

Ghana: Promoting Growth, Reducing Poverty

No country has achieved sustained poverty reduction without economic growth. In particular, growth that exploits the comparative advantage of a country, using its more abundant factor of production (i.e., labor), enables the income gains generated by it to be pro-poor. Ghana's Economic Recovery Program (ERP),

launched in 1983, follows a growth strategy that promotes macroeconomic stability and a liberal and neutral incentive regime. There is now clear evidence that these policies have also helped to reduce poverty-and substantially so. This reduction was widespread and broad-based, benefiting mainly rural areas and the most vulnerable group-female-headed households. So, what were the policy changes that spurred growth? How did the pattern of growth help the poor? And how can such growth be promoted?

Policy Reforms and Growth

The policy reforms since 1983 have reduced the fiscal deficit and inflation, helped improve infrastructure services, and shifted relative prices and incentives towards the tradables sector, in general, and towards exports, in particular. The key element of fiscal consolidation up to 1991 was the growth in government revenues, whose share of Gross Domestic Product (GDP) rose from 6 percent in 1983 to 13 percent in 1986 and to 16 percent in 1991. Higher revenues made it possible to reduce the fiscal deficit and, at the same time, increase public investment in infrastructure which had virtually collapsed prior to 1983. Prudent monetary management also

led to inflation falling from 123 percent in 1983 to 40 percent in 1986 and 18 percent in 1991. The resulting improvements in macroeconomic stability made it possible for farms and firms to respond to the shift in production incentives induced by the policy reforms. As a result of these reforms, the economy turned around. Although economic activity witnessed its biggest surge during the early years of the ERP (5.3 percent annually during 1983-86), aggregate growth has averaged 4.7 percent per annum since 1987. The private sector has made a significant contribution to growth. However, this growth performance has not been uniform across sectors. Agriculture recorded an annual growth rate of only 1.9 percent since 1987 while services have grown at an average annual rate of 7.4 percent over the same period. Merchandise exports and imports have grown faster than GDP and with it, complementary wholesale and retail trade. The share of external trade in GDP increased from about 5 percent in 1983 to 32 percent in 1986, 35 percent in 1991, and 55 percent in 1994.

Poverty Reduction

With growth, poverty fell. Recent analyses of the Ghana Living Standards Surveys of 1987-88 and 1991-92 reveal that the headcount index of poverty declined from 37 percent in 1987-88 to 32 percent in 1991-92. Rural poverty fell from 42 percent to 34 percent. Economic growth effectively 'pulled up' the rural poor who have gained proportionately more. The overall depth of poverty also declined. The mean expenditures of the poor were 12 percent below the poverty line in 1987-88 but by 1991-92, it had improved to 8 percent. The poverty differential between rural and urban areas appears to have narrowed from 15 percentage points in 1987-88 to 7 in 1991-92. Even though poverty increased in Accra, poverty there remains well below the national average. There was also a dramatic reduction in poverty among households headed by women—from 39 percent to 29 percent (the corresponding change for households headed by men was from 36 percent to 33 percent) implying that (i) most of the aggregate reduction comes from the fall in poverty of households headed by women, and (ii) the differential in the incidence of poverty between the sexes was reversed. The reduction in poverty is due largely to economic growth. Ghana's growth between 1987-88 and 1991-92 averaged almost 5 percent per annum, which translated into 2 percent annual growth in per capita GDP. The poorest groups also benefited from growth which is significant, as in many other countries, the reduction in poverty is typically accompanied by a worsening in income distribution. For the poor and the non-poor alike, farm income is the dominant but declining source of income. Non-farm self-employment is the second most important (and growing) source of income, and wage employment the third. The decline in rural poverty appears largely due to growth in non-farm self-employment—essentially trading. The growth in domestic trading is no doubt due to the surge in both imports and exports during the period of the ERP.

Investing in People

Even with the best economic policies, rapid growth with poverty reduction will elude Ghana unless more is invested (and more effectively) in health and education. Though spending on the social sectors has increased significantly from the low levels of 1983, current levels remain low relative to comparable countries. In addition, the quality of both health care services and education is inadequate with insufficient expenditures on non-wage operations and maintenance, both essential to improving the quality of education. The aggregate levels of public spending on

health and education has been generally regressive in absolute terms-that is, less goes to the poor, more to the rich. Between 1989 and 1992, health spending on the poorest fifth of the population fell from 12 to 11 percent of total health spending. The share for the richest fifth rose from 31 to 34 percent. Education spending was only marginally regressive in absolute terms in 1989 and 1992, being distributed almost uniformly across income groups. In 1988, the poorest fifth had 17 percent of total education spending, compared with 24 percent for the richest fifth; in 1992, the poorest got 16 percent and the richest 21 percent. Even within the various levels of health care - inpatient services, outpatient services, and health centers and clinics - public expenditures have been generally regressive with the poorest fifth receiving less than their proportional share of public spending on these services. There is also a huge urban bias in the regional distribution of health spending as well as gender differences in public health spending with poorer women being the most disadvantaged. Within the various levels of education- primary, secondary, and tertiary, the story is largely the same-more to the rich, less to the poor-except in primary education where the poorest fifth received more than their proportional share of public spending. Rural-urban inequalities are also evident. While per capita expenditures for primary education are higher in the rural areas, the rural-urban inequalities are strong and worsening in secondary and higher education. There are also gender inequalities across all education levels but worst in secondary education.

What Else Needs To Be Done?

Ghana's past success in reducing poverty clearly shows the crucial role of broad-based economic growth, most of which came from the private sector. Future growth, too, must come from the private sector. Rapid agricultural growth will be critical to future private sector growth and, given the predominance of rural poverty, the key to continued reductions in poverty. But increasing the quantity and quality of investments in human resources will also be absolutely essential to promoting rapid private sector growth. Additionally, there are 5 other actions that the Government can take to promote private sector growth:

(i) Sustain Macroeconomic Stability.

In 1991, Ghana was poised for rapid economic growth with a good macroeconomic framework in place. Instead, there was the 1992 fiscal shock, triggered by across-the-board wage increases of 80 percent for civil servants and by a fall in tax revenues, and further accentuated by a shortfall in foreign program grants. Private investment fell precipitously-to 4.3 percent of GDP in 1992. The fiscal accounts (excluding capital expenditures financed through external project grants and loans) slumped from a surplus of 1.5 percent of GDP in 1991 to a deficit of 4.8 percent in 1992. Subsequently, during 1993-94, the Government (a) took key policy decisions to promote an enabling environment for the private sector, including the accelerated privatization of state-owned enterprises and further liberalization of the regulatory framework, and (b) engineered a substantial fiscal turnaround of around 4 percent of GDP. Yet the legacy of the fiscal shock and lax monetary management led to higher inflation which in 1994 averaged 25 percent.

So, how can the Government ensure macroeconomic control, particularly in view of the forthcoming general elections in 1996? It can do this by avoiding another large wage shock,

reducing public expenditures as a percentage of GDP, ceasing public sector access to central bank credit, and maintaining tight monetary control.

(ii) Mobilize Private Investment in Infrastructure.

Private investment-both domestic and foreign-needs to be harnessed for infrastructure expansion. International best practice has demonstrated that private ownership and competition, combined with an appropriate regulatory framework, can trigger better productivity and service expansion in most infrastructure sectors. But in Ghana, current ownership of infrastructure is a far cry from international best practice and various barriers to private sector participation exist. These can, however, be obviated by establishing and following transparent and predictable regulatory procedures, removing pricing and entry regulations, and introducing detailed regulations governing service obligations, enforcement, etc., where required.

(iii) Strengthen the Financial Sector.

Weaknesses in the financial sector in Ghana constrain domestic resource mobilization. This restricts financing opportunities for productive private investment and is a serious impediment to business growth and expansion. Financial intermediation is low mainly due to lack of confidence in the financial system, insufficient competition, and the weak financial infrastructure. The main challenge is to bring more savings into the financial system to finance productive private investment. This means reviving confidence in the banking system (including divesting state-owned banks), promoting competition in the financial sector, supporting informal financial intermediaries, investing in legal and financial infrastructure, and enhancing intermediation by rural financial institutions, particularly rural banks.

(iv) Liberalize the Cocoa Sector.

Ghana was the world's leading cocoa producer for most of the 20th century. In 1964, production peaked at 550,000 tons-33 percent of the world market. By 1983, however, production had fallen to 159,000 tons and the country's world market share to 9 percent. While there has been a modest recovery since, the efficiency in the sector needs to be enhanced by removing the two main policy distortions affecting it-(a) the Government's monopoly in the export of cocoa, and (b) the heavy taxation of the sector, whether explicit or implicit. Removing these distortions is critical to restoring farmers' incentives for investment and production, revitalizing the sector, and increasing the incomes of the poor.

(v) Liberalize the Petroleum Sector.

The petroleum sector is characterized by a public monopoly in the importation and refinement of crude, and in significant government involvement in the distribution of petroleum products. Moreover, administrative regulation of retail prices make it more difficult to pass on to the consumer the higher import costs due to the depreciation of the cedi. Private sector growth would be promoted by removing the monopoly of the Ghana National Petroleum Corporation over the procurement of crude petroleum, privatizing the refining and distribution agencies, and decontrolling petroleum prices.

Conclusions

Despite the gains that Ghana has made, poverty remains a serious and extensive problem. For 32 percent of the population, or about 5 million people, expenditures per capita in 1992 were less than US\$25 a month. However, poverty reduction can be expedited through proper policies. This suggests three things. First, since strong economic growth, that is at least distributionally neutral, has been shown to be a fundamental requirement for effective poverty reduction in Ghana (as elsewhere), the pursuit of proper macroeconomic policies to promote private sector growth is a must. Second, since poverty is largely a rural phenomenon, agriculture sector policies are crucial in any strategy of poverty reduction. And third, investments in human capital and better targeting of public social expenditures are required if growth is to be sustained and poverty is to be reduced.

However, there are concerns over whether future growth will be as broad-based or sustainable as that experienced during 1987-88 and 1991-92 so that the poverty reduction is as sizable. This concern arises from the low human capital base of the poor, the lack of adequate targeting of public social expenditures, and the generally poor quality of health and education services. In addition, the low rates of agricultural growth, and the continued dependence on foreign aid also raise concern over the sustainability of long-term growth in Ghana. These questions are the agenda for future economic work which will seek to inform the debate on Ghana's path of accelerated growth with poverty reduction.

The World Bank. 1995. *Ghana: Growth, Private Sector and Poverty Reduction - A Country Economic Memorandum*. Report No. 14111-GH. Country Operations Division, West Central Africa Department, Washington, D.C. This article was prepared by Asad Alam, Task Manager for the above report. For copies of the report, please contact Ms. Ofelia B. Miranda, Room J-8058, The World Bank, 1818 H Street NW, Washington, D.C. 20433. Tel. (202) 473-4877.
