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Dilemma of a Developing Economy

by Professor Naseem Ahmad, Legon, Accra *

For the past ten years or so the economy of Ghana has been under severe strains. The domestic economic scene has been characterised by stagnation of production, by falling real per capita income, by ever growing inflationary pressures and by rising level of unemployment. On the external front, the economy has remained under severe pressures resulting partly from a chronically weak balance of payments and partly from the massive external debt.

The economic dilemma which Ghana has been facing since its independence is painfully plain and simple. Its economy is mainly dependent on cocoa, from which it derives 60 to 70 p.c. of its foreign exchange earnings. Ghana has always had a high propensity to import partly because it has not yet been able to meet its most fundamental need for food through local production and partly because its manufacturing sector built up mainly during the Nkrumah period is very much dependent on imported raw materials and spare parts. Moreover, the élite in Ghana, including civil servants and cocoa farmers, has developed taste for fairly sophisticated non-durable and durable consumer goods of foreign origin. As a result, the pattern of commodity use of the Ghanaian economy is highly import-oriented.

In the early years of independence when the world market price of cocoa was high, Ghana was able to earn sufficient foreign exchange to meet its import requirements without any difficulty. However, since 1960 the world market price of cocoa has witnessed considerable fluctuations. In the early sixties when the cocoa price was continuously declining, the country was able to make ends meet by running down its foreign reserves which were quickly used up. In the absence of reserves to cushion recession in the cocoa market, however, Ghana has had no option but to introduce stringent measures to restrain the demand for imports. But sudden reductions in imports have inevitably led to a recession in the economy and generated inflationary pressures and unemployment. This then is the basic weakness of the Ghanaian economy which so far three different governments have tried to correct with each of them using its chosen strategy, but which continues to dominate the economic scene in Ghana.

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Ghana's current economic difficulties date back to the early sixties when in an attempt both to raise the tempo of economic activity and to diversify the economy the Nkrumah government launched ambitious development plans which called for a rapid rise in government expenditure and inevitably led to a continuous deterioration of the budgetary and balance of payments positions. But Nkrumah managed to keep bonanza rolling by large-scale borrowing both from the domestic banking system and external sources. Over the six-year period 1960 to 1965 the government incurred a budget deficit totalling nearly £ 250 mn, of which nearly one-third was financed by borrowing from the banking system. The large annual doses of deficit financing generated excess demand forces which kept domestic prices zooming and the balance of payments gap widening. An idea of the inflationary tension in the economy can be had from the fact that between March 1963 and July 1965 alone the national price index had gone up by 63 p.c. At the same time, a crisis arose in the balance of payments position: by the end of 1965 the external reserves—which at the time of independence in 1957 are believed to have amounted to nearly £ 200 mn—had virtually disappeared, and the country had accumulated an external debt of £ 220 mn.

"Stabilisation and Consolidation" Policy

The National Liberation Council (NLC) which came to power as a result of the successful coup in February 1966, tried to bring some semblance of order into the economy by pursuing a policy of "Stabilisation and Consolidation". To reduce the pressure on domestic resources and on the price level, government investment expenditure was substantially cut down and thousands of workers in public corporations and agencies were system-

atically laid off. And in an attempt to restore equilibrium in the balance of payments, imports were cut down partly by tightening up physical controls and partly by holding down the level of investment and employment. But despite these corrective measures the balance of payments position did not show any significant improvement. The scarcity of foreign exchange during 1966 and 1967 was compounded in part by a stagnation in receipts from exports and in part by the outflow of debt servicing payments which were far in excess of the fresh long-term loans made available to Ghana by the Western countries. In a further attempt to tackle the balance of payments problem, in July 1967 the NLC decided to reduce the external value of the Ghanaian currency by 30 p.c.

The NLC did succeed in bringing the fire of inflation under control. Available data indicate that between 1966 and 1968 the national consumer price index increased at an average rate of 3 p.c. per annum. The balance of payments position also showed considerable improvements particularly in 1968 when the current account deficit declined to £ 20 mn compared with nearly £ 80 mn in 1965. It must be emphasised, however, that these results were achieved at heavy costs in terms of stagnation and unemployment. Between 1966 and 1968 the gross domestic product in real terms increased at an annual rate of 0.8 p.c. compared with the nearly 3 p.c. per annum growth of population. Consequently, real per capita income fell continuously from \$ 142 in 1965 to \$ 134 in 1968.

Nor should the improvement in the balance of payments after the 1967 devaluation mislead us. The payments position in 1967 and 1968 had improved not due to any increase in receipts from exports but largely due to a decrease in imports of investment goods and industrial raw materials. Contrary to the expectations of its authors, the July 1967 devaluation did not lead to an export boost. Timber export which was expected to benefit most from the devaluation showed only marginal improvement. But even this modest beneficial effect was virtually offset by a decline in certain traditional mineral exports. On the other hand, devaluation inevitably and immediately led to a sharp rise in the prices of imported goods.

It must be added, though, that on the whole prices of imported investment goods and industrial raw materials rose more rapidly than those of the consumer goods. This resulted largely from the fact that the devaluation exercise was accompanied by the decision to waive or substantially reduce import duties on essential commodities, whereas equipment, spares and raw materials

continued to remain subject to the specific licensing system. This shift in the end-use composition of imports was reflected in the inefficient use of the existing plants and equipments, in the irregularities in the flow of domestic production, and in the rising unit costs.

Import Liberalisation

The "Consolidation and Stabilisation" period under the NLC was brought to a close in the middle of 1968 when a Two-Year Development Plan for the fiscal years 1968/69 and 1969/70 was introduced. The Plan aimed at resuming economic growth at the annual rate of 5 p.c. and at reducing unemployment. Since this growth target was to be achieved largely through a greater and more efficient utilisation of the installed capacity and since the previous restrictive import regime had tended to perpetuate distortions in the productive structure of the economy, the NLC found it necessary to switch over to a policy of import liberalisation.

To this effect the OGL (Open General Licence) system was widened to cover spare parts and industrial raw materials required by a large variety of domestic manufacturing industries. In addition, imports of a number of items were exempted from the mandatory 180-day credit requirement, which had resulted in increasing the cost of commodity imports by at least 15 p.c. The policy of import liberalisation and the consequent rise in the level of imports coincided with a number of favourable developments in the external sector. To begin with, as a result of the debt rescheduling arrangements reached in October 1968, the debt servicing payments in 1968 and 1969 were sharply reduced. Secondly, the gross inflow of suppliers' credits from official sources went up from about \$ 0.2 mn in 1968 to nearly \$ 9 mn in 1969. Finally, and more importantly, owing to a significant rise in cocoa price, caused by extremely short crops in West African countries, export receipts in 1969 went up by nearly 14 p.c.

Growing Import Surplus

The civilian government of Dr Busia, which assumed office in September 1969, decided to embark on a programme of accelerated growth following the corrective measures of the NLC. The scope of the OGL system was significantly extended so that in 1971 it covered nearly two-thirds of commodity imports. The liberalisation programme soon led to a boom in imports of food and less essential consumer goods. To contain this trend, surcharges on imports of certain non-essential items were imposed, which by and large proved ineffective. Nor did the removal of admin-

istrative controls lead to the expected increase in imports essential for investment and capacity utilisation, and thus the hopes of rapid increase in domestic production proved unfounded.

Alarmed by the rising import bill on the one hand, and a decisive relapse of the world cocoa market on the other, in its July 1971 Budget the Busia government announced sweeping and drastic measures. To reduce the trade gap, importation of a variety of goods, including cars, was completely banned, and additional levies on goods subject to specific licensing were imposed. To curtail invisible trade obligations, foreign exchange transfers in respect of private, business and official activities were made subject to a tax ranging from 10 to 25 p.c. In addition, certain fringe benefits to the civil servants, notably the monthly car allowance, were cancelled and a national development levy was imposed on all employees, self-employed persons and companies. This last-named measure resembled the Compulsory Savings Scheme which Nkrumah had introduced ten years ago in July 1961, and which had led to industrial unrest and political tension. The development levy perforce revived the memories associated with its predecessor and proved equally unpopular.

The 1971 Devaluation

The de facto selective devaluation implied in the imposition of the tax on the use of foreign exchange for certain specific purposes was followed by a general though relatively modest devaluation in November 1971, when the cedi was pegged to the dollar, and in anticipation of the dollar devaluation, the rate of exchange between the cedi and the dollar was reduced by nearly 5 p.c. Since subsequently the dollar was devalued by 8.6 p.c., the unofficial devaluation in November 1971 ultimately reduced the rate of exchange between the cedi and the pound sterling by nearly 15 p.c.

Meanwhile, the balance of payments position continued to deteriorate. Available information indicates a current account deficit in 1971 of about £ 60 mn, almost twice the level in 1970. On the other hand, the prospect of recovery in cocoa price became increasingly dim. In addition, substantial debt repayment obligations were soon due and the probability of obtaining fresh relief at the next round of negotiations with the creditor countries appeared low. Above all, repayment of about £ 11 mn to the IMF in respect of stand-by credits obtained in the years 1966 and 1967 was soon due, and it seems that the IMF was willing to grant fresh short-term credits *only* under certain usual conditions (including devaluation?). In desperation, the Busia government succumbed to

these pressures, and on December 27, 1971, officially reduced the value of the cedi from 98 to 55 US cents.

Likely Impact on the Trade Gap

The likely impact of the 1971 devaluation on the Ghanaian economy can be analysed in two stages: first, the effect of devaluation on exports, and second, its effect on imports. In considering the effect on exports it seems useful to divide Ghana's exports into three main groups. In the first group we can include cocoa, diamonds, gold and coffee, which account for nearly two-thirds of the country's export receipts. These commodities are sold in the well-organised international markets and their prices are fixed and quoted in dollar and pound sterling, which Ghana cannot change unilaterally. Devaluation is therefore not likely to increase Ghana's export earnings, especially from cocoa, whose supply in the short run is relatively inelastic, and whose demand in the long run is not sufficiently price-elastic.

In the second group we can include exportables like timber, manganese and bauxite which currently yield altogether about 20 p.c. of the total export receipts. Their prices are also quoted in dollars and pound sterling, but their markets are not well-organised and fully competitive. Exports of these commodities could therefore have benefited from devaluation. However, due to certain practical difficulties which had been encountered after the July 1967 devaluation, export receipts from these commodities would have shown only some marginal increase. This in part is explained by the fact that in timber trade Ghana faces tough competition with its neighbour, the Ivory Coast, whose association with the European Common Market gives it an upper hand. Moreover, and this applies to gold and diamonds as well, increased costs of imported extractive machinery and equipment needed for manganese and bauxite production would have raised the unit costs and thus at least partly neutralised the favourable impact of devaluation on their exports.

This leaves us with the final group of exports which includes a large variety of items ranging from fruits and vegetable oils to textiles, shoes and plastic goods. These commodities account for only 5 p.c. of the total exports and are largely sold to the West African neighbour countries. It is this group of exportables which perhaps would have derived the greatest benefit from devaluation, provided, of course, that: first, the cedi prices of these commodities had either remained at the pre-devaluation level or increased at a rate lower than the downward exchange-rate adjustment; and, second, Ghana would have been able to in-

crease the output of such and other non-traditional exports.

A closer look at the nature and structure of Ghana's existing productive capacity, particularly in the manufacturing sector, leaves little reason to expect that these conditions would have been met. Ghana does have large idle capacity in the manufacturing sector and most of its state-owned manufacturing enterprises have always operated at a level far below the full capacity. It must be remembered, however, that this idle capacity is largely the result of the absence of complementary factors of production, including skilled labour, spares and raw materials, which have to be imported, and which would have been rendered considerably more expensive by the devaluation. The import content of the manufacturing sector in Ghana is estimated to range from 40 to 60 p.c. This means that the 1971 devaluation would perforce have increased the costs and hence the selling prices of locally manufactured goods by 35 to 50 p.c. Besides, the wage and salary increases granted immediately after the December 1971 devaluation would have raised the unit cost by another 10 p.c. Altogether then the unit cost of locally manufactured goods would have gone up by 45 to 60 p.c.

On this basis, the massive devaluation of December 1971 would have reduced the export prices of the locally manufactured goods in terms of foreign currencies by only 10 to 15 p.c. Add to this the fact that the 25 p.c. export bonus which was granted in 1970 to encourage exports was removed consequent upon the devaluation exercise and one can see that the 1971 devaluation would have amounted to a net loss of 10 to 15 p.c. to most exporters and thus proved ineffective in encouraging exports of locally manufactured goods.

Turning to its impact on imports, there can hardly be any doubt that the 1971 devaluation would have led to an across-the-board increase in import prices by 80 to 90 p.c. This immense rise in import prices would, no doubt, have led to a drastic cut in the physical volume of imports, especially of non-essential and luxury goods. It is clear, however, that in view of the country's deficiency in local food, at least in the short run, even this massive rise in import prices would not have proved effective in discouraging the overriding demand for imported food. Inevitably, therefore, the cost of living of the ordinary Ghanaian would have suddenly jumped upwards. The inflationary pressures and the resulting social discontent would undoubtedly have been compounded by the rise in the prices of locally produced food and manufactured goods.

The conclusion which emerges from the foregoing analysis is that while the resulting gains in terms of increased export would have been highly marginal, the 1971 devaluation would have worsened the country's (money) terms of trade, squeezed imports, increased inflationary pressures and compounded the unemployment situation. This conclusion is partly confirmed by the events immediately after the devaluation. There was an instantaneous and astronomical rise in the prices of essential commodities like rice, flour, sugar, milk, and most of the consumer durables immediately disappeared from the shops, many of which were temporarily closed down. Moreover, to most of the Ghanaians the 1971 devaluation spelled a loss of national prestige and a clear sign of economic mismanagement by the Busia government.

The 1972 Revaluation

The immediate cost of the devaluation, however, turned out to be the overthrow of the democratically elected civilian government. Whether this cost in political terms is to pay any economic dividends remains to be seen. But what is already obvious is that the new regime, the National Redemption Council (NRC) has courage to act, which was reflected in two major decisions it took soon after coming to power. The first of these decisions was the upward adjustment of the exchange rate by 42 p.c., which with effect from February 7, 1972, raised the value of the cedi from 55 to 78 US-cents. This action, incidentally, makes Ghana the first developing country to introduce a currency revaluation. The second decision was to undertake a thorough and rigorous review of the terms and conditions of external debts and to reject all obligations arising from suppliers' credits found tainted with fraud and corruption. As a first step in this direction, the NRC repudiated debt obligations amounting to £ 66 mn arising from contracts with 4 British companies, and suspended for 10 years the repayment of the remaining two-thirds of suppliers' credits.

In conclusion, it is hard to understand how the massive devaluation of December 1971 would have proved effective in pulling Ghana out of the vicious circle in which its economy has been moving for the past ten years. And it is equally difficult to see how the subsequent revaluation and certain accompanying measures can by themselves eliminate the basic weaknesses of the economy. So far, Ghana's economic problems have not lent themselves to conventional solutions. The future of the Ghanaian economy would remain dismal until a serious search for new and more realistic policies begins with the aim of attacking the various problems at their very roots.