

Strategies to stimulate Ghana's economic transformation and diversification

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Abstract

After metamorphosing into a lower middle income country, Ghana needs to transform and diversify its economy if it is to consolidate its lower middle income status, reach upper middle income status and drag more of its people out of poverty. Pertinent questions that remain unanswered include: what are the principal self-imposed problems Ghana needs to resolve; what are the institutional changes Ghana needs to make to transform and diversify its economy and what lessons can Ghana glean out of the experiences of other countries that have transformed their economies? Using a comparative analysis of published research and economic analyses, based on the available literature, this paper provides some answers to these questions.

Key self-imposed problems include: weak institutions highlighted by a 'winner takes all' democratic governance structure that disenfranchises Ghanaians with no connections to the ruling party; weak management of the macro-economy; extremely high cost of borrowing; an unstable exchange rate; high import taxes; a narrow tax bracket with the majority in the informal sector paying zero taxes reducing government revenue; endemic corruption; ineffective land tenure; an inadequate transportation network; unreliable access to electric power; inability to engage in manufacturing; poor sanitation; difficulties in curtailing illegal mining and widespread indiscipline that makes management of people unduly challenging. Critical institutional reform needed includes a constitutional review that limits the power of the executive and makes him accountable for his actions.

The number of appointments that the executive has

to make to technical and professional leadership positions in the public service and production sectors must also be reduced. The status quo forces the President to make appointments to leadership positions in which he has no experience and confounds the political and economic lives of Ghanaians. Public institutions must be rid of political influence to purge them of political sycophancy, improve the technical capabilities of their leadership and increase their effectiveness.

Ghana also needs to get aggressive about limiting avenues for corruption. This can be achieved by eliminating the loopholes and conflict of interest inherent in the constitution that allows corrupt practices to go unpunished especially on the grounds of technicalities: an independent corruption prosecution agency is essential in this regard. The rule of law must be strengthened – particularly in the rural areas and inner cities – and progressive land reform must be carried out. The current situation where fertile southern agricultural land is being co-opted for real estate must be halted to reduce the twin risks of food inflation and food insecurity in the future. A real effort must also be made to break through long-held and negative socialist and traditional views about private ownership so property rights can be properly acknowledged and enforced.

Keywords: Economic transformation, Institutional changes, Corruption, Diversification, Self-imposed problems, Food security

JEL classifications: L43, N67, N77, O14, O17

Introduction

After gaining its independence in 1957 Ghana first promised much, appeared to deliver on its promise for a short while and then endured a long period of economic and developmental stagnation caused by internal problems. Ghana then recovered in the mid- to late-1980s and its economy subsequently expanded robustly after years of enjoying political stability followed by a peaceful transition to democracy in 1992 (Meng 2004 and Watkins 2004).

While the first decade after independence (1957-1966) was moderately progressive probably due to large reserves left over from colonisation and Kwame Nkrumah's expansive and aggressive industrial policies, the following two decades 1967-1976 and 1977-1986 were very difficult for Ghana as military dictatorship took hold in the country, interspaced by short periods of democratic rule. The country also suffered its most severe drought in 1983 and absorbed returning Ghanaians repatriated from Nigeria following an aliens compliance order in that country. A World Bank sponsored Structural Adjustment Program (SAP) initiated in the early 80s by the People's National Defense Council (PNDC), which ruled the country from 1981-1992, ignited a rebound for Ghana. Analysis of macroeconomic data from the Ghana Statistical Service indicates that Ghana's growth in decades post mid-80s (1987-1996, 1997-2006 and 2007) has been strong, although the growth rate since 2012 has been steadily declining.

A comparison of Ghana's economic performance with countries which were at par with Ghana at independence – such as Botswana, South Korea and Taiwan in terms of GDP per capita growth; poverty alleviation; educational attainment and human capital development; anticorruption efforts; access to capital; and improvements in health – seems to suggest very little has gone right for Ghana. However, comparison of Ghana to other African countries using the same metrics paints a more positive picture as Ghana was the seventh most prosperous country in Africa according to the Legatum Institute in a report carried on CNN's market place website on 15 August 2015. Ghana is also the second safest place to live in all of Africa (CNN, 2015).

Ghana, however, still faces today similar problems that it faced after independence, and that all poor developing countries continue to face, despite its new tag as a lower middle income country (Bates, 2008). The manufacturing sector has declined sharply and failed to give the relevant development stimulus and the associated high-paying manufacturing jobs associated with a vibrant manufacturing sector. Transportation also remains a monumental problem facing consumers and businesses alike in Ghana. Moving people and especially heavy goods

around Ghana is slow, uncomfortable and unsafe. Transportation problems are followed by challenges in obtaining access to electricity, capital for business investment, corruption and a socialist type winner takes all governance that charges very high indirect taxes for example at the ports, border crossings and for services and in road tolls. The state directly taxes only the very few citizens in the formal sector while the majority of the citizens in the informal sector pay no direct taxes at all, reducing government tax revenues and unduly stressing the few formal sector tax payers. Even agriculture where the cocoa industry dominates has come under severe stress. Cocoa production faces competition not only from neighbouring Cote d'Ivoire but cocoa land is also under pressure from real estate developers. Oil-related demand for cocoa land is intense in the oil-rich Western region undermining agricultural efforts and exposing the country to the twin risks of food inflation and food insecurity.

Figures 1-2 (see page 16) graphically display the performance of the Ghanaian economy from 1992-2014 representing the period after democracy was instituted. While figure 1 compares real and nominal GDP per capita, figure 2 compares inflation and nominal GHC/US\$ exchange rates over time. Ghana enjoyed some strong performances after the oil discovery in 2010 and was at one point in 2011 enjoying the strongest nominal growth of any country in the world (15%) while keeping inflation at a single digit.

According to GSS data, Ghana's performance has weakened recently as GDP per capita growth has slowed down to 5% (Daily Graphic, July 2016). Real GDP may be negative although the official figure is lower than 4%. While inflation is close to 20%, interest rates (the rate for commercial banks) just rose to 30% in March 2016 while the Cedi (the national currency) lost more than 40% of its value between January and July 2014 as national debt soared and government expenditure escalated.

A decision to go to the IMF for a bail-out seems to have steadied the ship but the government's continued borrowing and lack of political will to fight corruption calls into question the sustainability of the recent gains in arresting the fall of the Cedi.

A major claim this paper makes is that most of Ghana's woes may be traced to its weak institutions (according to the criteria for strong institutions outlined by North, 1991 and Acemoglu and Johnson, 2001) and a 1992 Constitution littered with conflicts of interest that arrogate enormous power to the executive, and guarantees a winner takes all government that disenfranchises a majority of the population. The paper discusses strategies for Ghana's economic transformation and diversification to enable Ghana to realise its potential.

Economic transformation in this context implies taking steps to change the economy from its current low income state with majority agricultural subsistence farmers into a high income country of industrial manufacturers and mechanised farmers (Torado, 2006 and Nafziger, 2006). This process of changes involves corresponding transformation of low-to-high-income characteristics. The low-income characteristics include subsistence living; a high population growth rate; limited access to capital and high cost of borrowing; chronic poverty; persistent unemployment; low levels of education; poor sanitation and health; and weak institutions (Nafziger, 2006 and Todaro, 2006). Obviously high income characteristics are the opposite of the low income counterparts.

In comparison, the diversification of Ghana's economy is also just as important because it implies the shift from the reliance on export revenue from a few primary export products like cocoa, gold and oil to a mix of value added products produced and sold domestically or abroad. A diversified economy has multiple sources of income and has incomes with significant magnitudes such that an adverse negative shock to one source of income is barely noticed. A diverse economy will inevitably assist the transformation process because it will guarantee the income stream needed to overcome the challenges of low incomes in a sustainable way.

Motivation and relevance

Although Ghana remains a relatively poor country, its reserves of natural resources, relatively strong educational sector, enduring democracy, media freedom and political stability as well as a population that is religiously and politically tolerant, makes it a candidate for good economic performance. However, despite determined efforts by Ghana's citizens and leaders to transform the economy, the country remains underdeveloped with a majority of its populace still subsistence farmers and 24.2% (GSS, 2016) of its population living below the poverty line. Agriculture remains rain-fed with little irrigation; the majority of the infrastructure like roads, bridges and ports are of low quality or are non-existent; public services like electricity, healthcare and water are unreliable; implementation of the law is weak; corruption is rife and sanitation and environmental degradation such as illegal mining and the pollution of rivers are egregious challenges.

For the reason that Ghana's current economic state appears transformable by taking the right steps, research such as this that identifies and discusses the steps needed to transform the economy, makes an invaluable contribution to the literature. The lessons from the research are useful not only to Ghana's executive

leadership and lawmakers but also to the leaders of other SSA countries struggling to transform their own economies. Finally, apart from contributing to the literature on development studies, the research results provide pertinent information for Ghana's development partners so they can focus their development assistance on activities that will actually transform and diversify Ghana's economy for sustainable development.

The institutions argument, an evaluation of the strength of Ghana's institutions and how they can be strengthened to complement the growth strategies of Ghana's economy

Douglas North defined institutions as "the humanly devised constraints that structure political, economic and social interaction" (North, 1990). In effect, institutions define the 'rules of the game'. They set the stage for what is acceptable and what is not acceptable for the leadership of a country. In economic speak, institutions outline the set of incentives that will dictate the behaviour of the leadership and hence pre-determine the development path that a particular developing country will take (North, 1990, 2008; Rodrik, Surbramanian and Tribe, 2004; Rodrik and Subramanian, 2003 and Kattel et al, 2012). Institutions will dictate the costs and benefits of the set of behaviours available to the leaders.

Acemoglu and Johnson (2004, 2010 and 2012) writing several years after North's Nobel-prize winning work reiterated and re-validated the roles that institutions play in development by clearly specifying the characteristics of weak institutions:

- 1 **Unfettered power in the hands of the executive or leadership.** In Ghana this translates into the power to hire and fire the heads of all public institutions – including the heads of corruption-fighting agencies such as the Attorney General's Department; the head of the Economic and Organized Crime Commission (EOCO); the Governor of the Central Bank and the Chairman of the Electoral Commission. Note that with the exception of a few cases and in contrast to the democracy of ancient Greece (that occurred several years before Christ and that elected its city officials to stiffen them to stand up to executive pressure) and the United States (where the terms of office of these appointees are long to insulate them from political power), the Ghanaian appointees are basically all appointed by the President for short terms. The President can replace them whenever he chooses, although in some very few cases the President has been denied the power to fire his own appointees.

- 2 **Extremely weak enforcement of the law.** In Ghana this results in the situation where egregious crimes of corruption are left unpunished as long as they are committed by members of the party in power. The existing institutions incentivise politicians to look for loopholes to avoid parliamentary scrutiny to collude with businesses and foreigners to plunder state owned resources.
- 3 **Poor enforcement of property rights which serves to deter investment:** a particularly unpardonable crime in Ghana and Sub-Saharan Africa. This is because incomes are low, marginal propensity to save out of total income is paltry, and perceived investment risks are particularly high so that foreign direct investment hardly ever gets in.
- 4 **An uneven playing field where opportunity is not broad-based and open to everyone.** In Ghana a sort of dualistic society has emerged with members of the incumbent political party recognised as citizens and the members of the opposition party perceived by government as 'the other'.

By North (1990)'s definition of institutions, Ghana's institutions are extraordinarily weak with the 1992 Constitution itself being the biggest culprit. It arrogates too much power to the executive and is silent on punitive measures for leaders that do not enforce the constitution. For example there is not much clarity on what should be done to either the President or parliamentarians who do not declare their assets. What happens to a sitting attorney general in Ghana who wilfully refuses to prosecute a ruling party financier who defrauds the nation through fictitious contracts then turns around and fills the pocket of the executive with bribes? Who will prosecute this attorney general? Another attorney general appointed by the same government accused of corruption or is the old attorney general supposed to prosecute himself? This is clearly not a serious way to tackle corruption.

Development lessons from some traditional developed countries: Japan, USA, and Norway

After being devastated by World War II, Japan's economy expanded rapidly and robustly (at an average rate of 7%) for the next 60 years after the success of the Dodge Plan which consisted primarily of dealing with inflation (Takada, 1999). Japan invested heavily in human capital enhancements and set in motion a version of state-supported market capitalism with foreign assistance from the USA that re-invigorated Japan and actually helped establish it as a shining Asian example for the successful Asian countries that followed

this model, in particular the Asian Tigers: Hong Kong, South Korea, Taiwan and Singapore (Asiedu, 2014, Page, 1994).

Japan's development strategy was heavily influenced by the ability of the Japanese people to learn how to use new technology, how to replicate and improve upon the technology and ultimately build new Japanese home-grown technology (Asiedu, 2012). In terms of the institutional environment that pervaded in Japan at the time it is quite clear that the defeat in World War II reduced the power of the emperor and put in place, a more democratic governance and, most critically, stronger institutions according to the definition of institutions by North (1990). In particular, rule of law and protection of property rights were strong and supported investment. Japan also focused on education but in particular protected certain key industries such as automobiles (Nissan, Toyota, Mazda, Mitsubishi and Honda), ship-building as well as electronics (Sony, Panasonic and JVC).

In comparison, the USA grew and developed rapidly in the 19th and 20th century, fuelled by intense internal trade because of its large size and diversified sources of production and commerce, and by large capital investments especially in agriculture, transportation and education. The institutional environment in the United States at the time of its growth ranked among the strongest anywhere in the world.

The USA is unquestionably the premier example of democratic governance in the world: there is enough limitation on the powers of the executive who has to pass through a Congress and a House of Representatives to effect laws. Property rights are strong, rule of law is enforced and opportunities abound for all sectors of the economy. In the period of its strongest growth, the states in the union enjoyed semi-autonomy where they could do certain things on their own without control from the federal government. Property rights and rule of law were so strong in the USA that it attracted huge amounts of foreign investment from everywhere in the world, especially in the 20th century. The USA also had an effective land tenure system and a social fabric that demanded transparency from government and offered opportunities to a broad section of the population. The USA encouraged innovation, funded research and education, and enticed highly skilled human resources from around the world, while rewarding innovation with a patent system

Norway's more recent growth spurt was on the back of discoveries of large reserves of oil. However instead of the typical corruption that can plague nation states with resource wealth leading to the kind of terrible economic performance that Sachs and Warner (2001) define as the 'resource curse', Norway used the oil revenues efficiently to improve the lives of the majority of Norwegians. Norway

managed to avoid the infamous 'Dutch Disease' which entailed an over-valuation of the local currency and a decline in exports of non-oil products that eventually undermined growth. Norway's management strategy is chronicled in its 'ten commandments of oil', which is a good reference for sovereign states seeking guidance on the management of oil revenues (Torku and Armah, 2016).

Analysis of self-imposed problems that haemorrhage Ghana's wealth

Apart from the institutional weaknesses that currently undermine Ghana's development efforts, there are some self-inflicted problems if, when addressed, can halt the loss of significant revenue for Ghana and Ghanaians now and in the future. For example the mining sector is currently hampered by both local and foreign illegal mining (galamsey). Both the local and the foreign illegal miners, typically from China, are destroying the environment. The Chinese use heavy machinery and apply toxic chemicals that obliterate the fauna and flora and severely pollute the water bodies. For instance the Ankobra, Prah, Offin and Densu rivers are barely alive and laden with pollutants causing severe water problems for the rural populations that depend on them for sustenance.

The problems in the mining sector are not limited to pollution and illegal mining. To truly transform the economy, Ghana needs to save some of its output so it needs to harvest the financial capital that the mining sector can bring in through exports. This means, like Botswana, Ghana needs to get more revenue back from the gold companies that exploit its mineral resources and prevent the repatriation of almost all the revenues as is the current situation. If possible, long-term mining contracts signed when the country was under dictatorship should be re-evaluated. Ghana must also add value to the gold it exports by processing it. This will bring in more revenues for the country and create jobs locally. In terms of the oil discovery, the Oil Revenue Management Bill should be strictly enforced to avoid the Dutch Disease and associated resource curse.

Secondly the level of economic knowledge in the country appears to be low. This makes simple economic phenomena like a devaluing currency appear so complicated to the populace that the Central Bank can take advantage of the situation to cloud its monetary policy, thus escaping blame for inflating the economy through seignorage or the inflation tax. There is also the absence of some essential legislation such as the right to information, antitrust, patents and externality laws (Armah, 2011, 2014). The absence of these laws encourages corruption, suppress innovation and risk taking and lead to misallocation of resources retarding growth.

Finally the agricultural sector (poultry, fishing and crop farming) needs to be revamped so that it can serve as the base for an agro-based industrial effort. In particular, effective irrigation schemes must supplant the current rain-fed agricultural practices so that grain production can continue all year round to feed the industries that will spring up.

According to Jeffrey Sachs no poor country that neglected its agricultural sector has been able to escape poverty, so the focus on agriculture is essential. According to Sachs "the first step out of rural poverty almost always involves a boost in food production to end cycles of famine" (Sachs, 2006).

In order to leverage agriculture for manufacturing, however, appropriate transportation and storage facilities as well as efficient training in supply chain, logistics, management and marketing are essential. However, the country has not invested sufficiently in these to reap the expected results. This is a self-inflicted problem that can be easily solved.

Summary of strategies that can potentially transform and diversify Ghana's economy

Japan and the Asian Tigers transformed their economies by improving their human capital. They trained their labour to gain the skills that enabled them to understand imported technology, analyse it, understand it, mimic it and improve upon it. Ghanaians should shun the current math phobia that pervades Ghanaian society and rather invest resources into improving math and science education to boost productivity. The government can also help the process by setting more obligatory math and science requirements in the curricular of secondary schools. This will help Ghana follow China's lead in being able to reproduce technology, improve on it and build newer, cheaper technologies appropriate for the African context.

The Ghana government should re-focus on its core business of government, which is the provision of public, not private goods. However, like the Asian Tigers, the government can provide an enabling environment for home-grown industries by reducing taxes, offering tariff protection for selected industries for which Ghana has a comparative advantage, ensuring stable electricity and potable water and guaranteeing an efficient transportation network for transporting cargo and passengers for start-ups. More specifically, a renewed focus on securing stable electric power by exploiting the various options, including wind, solar, agro-based options like ethanol fuel and biogas as well as liberalising the energy production to instill competition, should be high on the government's agenda.

Ghana needs institutional reform that limits the power of the executive. The law must be enforced, and the constitutions strengthened to incorporate a clear economic development plan with a term limit not subject to change by every incumbent political party. Market-oriented strategies must be developed, supported by government whose main function is not to produce or distribute consumption goods but rather provides public goods and helps to improve market efficiency. Government must enhance the businesses environment by charging low taxes while widening the tax bracket to include the informal sector who currently pay no tax, managing the macro-economy efficiently, limiting debt and inflation, and constructing vital infrastructures like roads, railway lines and bridges. Government should also assist businesses to situate in difficult regions of the country by providing accessible roads, power and water.

Ghana needs to get aggressive about limiting the avenues for corruption by eliminating the loopholes and conflict of interest inherent in the constitution that allows corrupt practices to go unpunished on the grounds of technicalities. For example, the idea that government corruption should be prosecuted by an attorney general who is appointed by government is self-defeating because no one will be prosecuted or, even if prosecution takes place, the criminals will be transferred elsewhere instead of jailed for their offences. An independent corruption agency is needed as Botswana's success has shown (Smith, 2006).

Further, the board of governors of the Central Bank and the board's chairman need to be insulated from government influence to print money by being granted long tenure (e.g. 14-year terms). This will limit the risk of hyper-inflation and prevent the Cedi from sudden losses of value. The heads of other public institutions such as the Commission for Human Rights and Administrative Justice (CHRAJ) and the chairman of the board of directors of the Central Bank need to be elected by the board members not appointed by the President.

Finally, Ghanaians need to ensure discipline in their private lives; develop a culture of diligence and personal responsibility; and eschew the type of attitude described in the local Twi language as "eye aban die", inherited from Ghana's socialist past where the state controlled most factors of production. This local expression is translated to mean "it belongs to government" and encourages people to care little about the consequences of their actions since government will bear the cost. This attitude typically involves shirking of duties, tardiness to work and a rejection of a maintenance culture because individuals do not face the full cost of their actions. Being more diligent would reduce the costs of monitoring by the government

and may positively impact productivity and the standard of living in the country.

In terms of lessons from other countries that transformed their economies, not one studied country could have developed without substantial investment in secondary education, investment in electric power generation and investment in road and rail infrastructure to link all major parts of the country and stimulate trade (Ranis et al, 2000 and Johnson et al, 2006). So Ghana should do the same. It should implement the free Senior High School (SHS) system as enshrined in the constitution and in the manifestoes of both the current government and the main opposition party. The incumbent National Democratic Congress (NDC) with John Dramani Mahama as President appears to be doing just that although they did previously ridicule the opposition about the practicality of such a policy.

Ghana must also finish the Accra-Kumasi road to link the North and South of the country. All the countries studied also pursued an aggressive export strategy and actually boosted the exports of not just primary products but also of value-added agricultural products and machinery as well, which diversified their economies. It does seem though that their emphasis on a continued weakening of the exchange rate does not apply to Ghana given the low export volume and the dependence on imports facing Ghana.

Ghana should also focus on optimum management of the macro-economy keeping inflation and debts level low. According to Botswana's president Festus Mogae "throughout the post-independence period, our debt-service ratio has been kept below 5% of exports of goods and services" (Mogae, 2005). This helped insulate the economy from external shocks and is good advice for Ghana. The Bank of Ghana must also be held accountable for wantonly inflating the economy as that is in direct contradiction of its mandate of keeping prices stable.

Conclusions

Despite several efforts to diversify and transform its economy, Ghana's efforts have been rewarded with little efforts because of institutional weaknesses that have given opportunities for corruption. Furthermore, lower than necessary investment in education, power generation, transportation infrastructure and mismanagement of the economy leading to high debt levels and inflation have hindered progress on transforming the economy. Finally, self-imposed problems have been major impediments to development

This paper has suggested some strategies to help Ghana transform and diversify its economy. Apart from

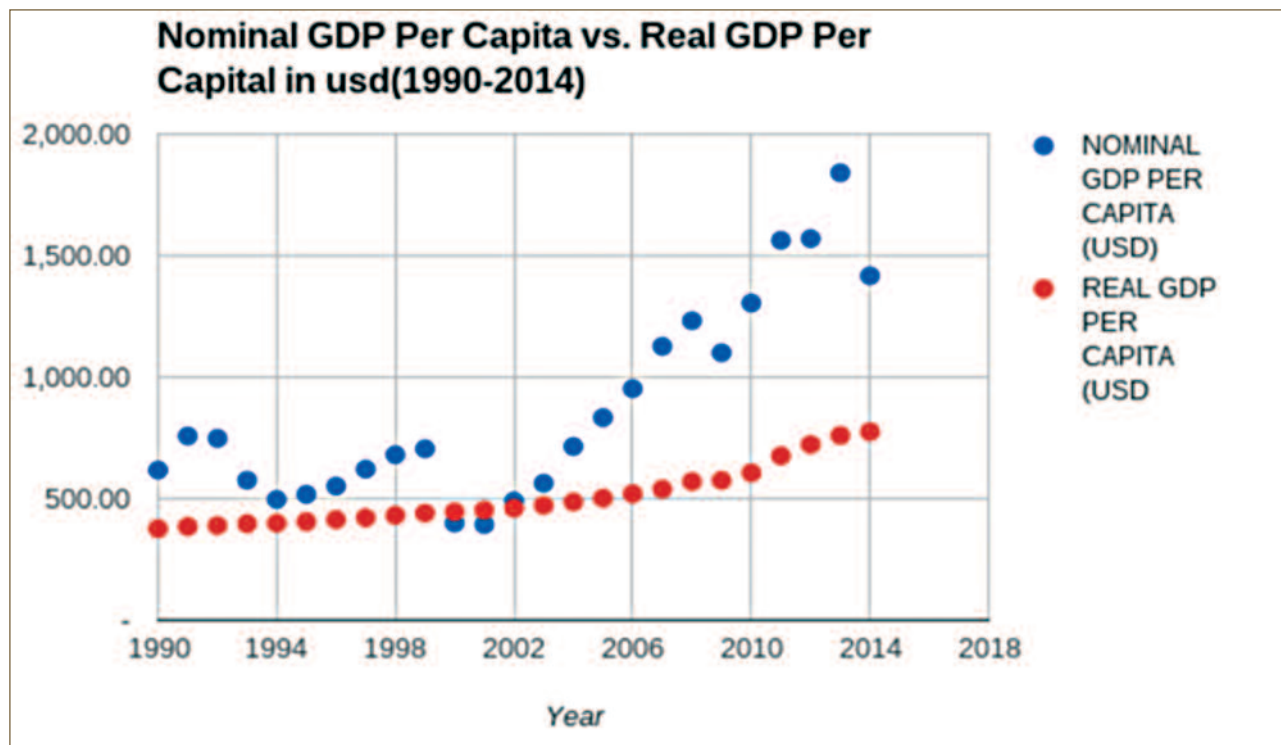
institutional reform to fight corruption, fiscal policy reform in the form of lower taxes and more prudent government expenditure as well as disciplined monetary policy is recommended. Further investment in education and a commitment to a national development plan that is insulated from political pressures will also help in the development process. Ghana is also well advised to demand more revenue from its mineral and oil resources while adding value before export. The Oil Revenue Management Bill should also be followed to the letter to avoid the resource curse and the necessary investment must be made in electric power generation in order to re-establish the manufacturing sector as a key employer. If Ghana follows these steps, it will be able to diversify and transform its economy.

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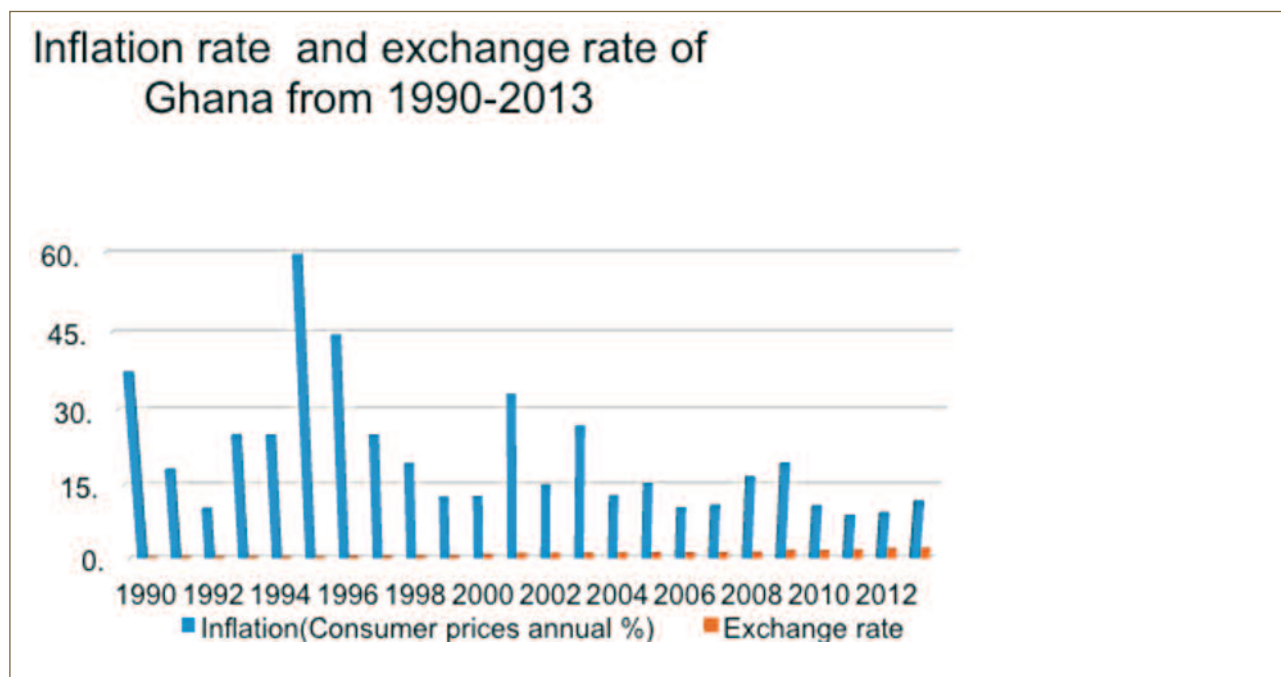
Appendix

Figure 1: A Comparison of real and nominal GDP per capita for Ghana: 1990-2014



Data source: Ghana Statistical Service

Figure 2: Inflation and ER for Ghana: 1990-2012 (the recent increases in ER are post 2013)



Data source: World Bank Data