LEGISLATIVE ALERT

A Publication of The Institute of Economic Affairs *Vol. 19 No.9 June/July 2012*

SINGLE-DIGIT INFLATION AND THE COST OF LIVING DICHOTOMY IN GHANA

by
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Summary

Ghana has a long history of high inflation rates, popularly attributed to supply not keeping up with demand. However, Ghana's current single digit inflation can be attributed to a number of factors including the reduction in global inflation rate and a stable exchange rate for a period of time. This single-digit inflation has spurred the discussion as to whether it is a true reflection of the situation on the ground. This article throws some light on the measurement of inflation and explains why there should be a dichotomy between the statistical measurement of inflation and the cost of living.

IEA Ghana

Legislative Alert is a bi-monthly publication of The Institute of Economic Affairs, Ghana, an independent public policy institute. This edition is sponsored by The International Development Research Centre (IDRC)/Think Tank Initiative. Subscriptions to the Legislative Alert are made available to those who make contributions to The IEA. Address all correspondence to:
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ISSN 0855-2452

Ghana has a long history of high rates of inflation. For decades, the country recorded double-digit inflation rates and in some cases even triple-digit rates. The empirical literature attributed Ghana's high rates of inflation largely to the classical explanation of supply of goods and services not keeping pace with demand. The slow growth of supply was the result of production bottlenecks, while demand was fuelled by expansionary fiscal and monetary policies. Apart from supply and demand factors, cost-related factors, particularly exchange rate depreciation and increases in petroleum and utilities prices from time to time put additional pressure on prices.

During the past decade, however, inflation has been significantly reduced. From 40.5 percent in 2000, inflation has been steadily reduced to 9.1 percent as of April 2012. The success in bringing inflation down is due to a combination of factors. Ghana has benefited from low imported inflation as global inflation has generally abated. Fiscally-driven demand pressures have declined in Ghana as budget deficits and associated financing have generally declined. The production and supply of food in particular, which is a major component of the CPI basket, has improved. Meanwhile, the exchange rate has been stable for longer periods than previously, reducing its impact on inflation. Finally, fuel and utility prices have been subjected to some degree of control, preventing their full pass-through to general prices.

Inflation was reduced to single digit in June 2010, which has since been sustained. This has been helped more by much lower rates of food inflation than nonfood inflation. The former has been in low single digits since January 2010 while the latter has been in the low double-digits all the time. With the achievement of single-digit headline inflation, a debate has emerged in the country as to what extent it reflects the situation on the ground, in terms of the general cost of living. Some people have even questioned the reliability of the official inflation figures. This article throws some light on the measurement of inflation and explains why there could be a dichotomy between the statistical measure of inflation and the cost of living.

Measurement of Inflation

The Ghana Statistical Service (GSS) currently measures inflation by using a basket comprising 242 consumer goods and services. The base year for computing the inflation figures is 2002. The GSS periodically collects price data on all 242 items. The primary data is collected mostly in non-standardized units, which are then standardized by GSS. The individual items in the CPI basket have weights based on the last consumer spending survey. The weighted prices are converted into indices with 2002 as the base year. The average price index for all 242 items is used to compute the rate of change of the index or inflation over a period of time—a month, quarter, or year—by comparing with previously-calculated indices.

Some people have tried to compare what they see to be much higher movements in the prices of some of the items in the CPI basket with the rate of inflation compiled by GSS and have argued that the GSS might be understating the true rate of inflation. There are factors that could introduce biases into the final inflation figures, although not in a particular direction. For instance, it is possible that an item that was on the market previously is no longer available. How would SS handle this situation? Would it find a close substitute or enter the same price as before? This would certainly introduce some bias into the estimates. Other factors may cause the inflation estimates to seem to deviate from the actual cost of living. These include the composition of the CPI basket and the weights attached to individual items. These factors are discussed below.

It has to be said that the way to validate GSS's inflation estimates would be to start from the raw data collected for the 242 items. We wanted to this but could not because, as we have explained above, the raw data is not in standardized units and, therefore, cannot be used as such. Using the data that has been standardized by GSS will, however, not allow one to validate the original prices and, therefore, the inflation figures calculated from them.

In the absence of this validation, we would give GSS the benefit of the doubt, for the purposes of this article, and take the inflation figures to be genuine. In any case, we do not expect that GSS would manipulate the data in order to achieve inflation figures that suit any particular constituency or constituencies, as that would be professionally unethical. We want to believe that GSS applies the same methodology all the time in calculating its inflation figures.

A case could, however, be made for a review of GSS's methodology used to calculate inflation figures, especially if it is widely believed that the existing methodology is outdated and that it does not fully represent current expenditure patterns. Let us use Table 1 as an example.

Table 1: Current CPI Basket and Weights (Base Year is 2002)

Item	Weight
1. Food & non-alcoholic beverages	44.91
2. Alcoholic beverages, tobacco, etc	2.23
3. Clothing & footwear	11.29
4. Housing, water, electricity, gas & other	6.98
5. Furnishings, household equipment, etc	7.83
6. Health	4.33
7. Transport	6.21
8. Communications	0.31
9. Recreation & culture	3.04
10. Education	1.60
11. Hotels, cafes & restaurants	8.28
12. Miscellaneous goods & services	2.99
All items	**100.00**

The Table shows a 12 item aggregated form of the CPI basket with the composite items and their relative weights. One can argue about what needs to be in the basket and what needs not be in as well as about the relative weights given to individual items. In fact, one may even go down to all the 242 items in the CPI basket in making these arguments. The decision as to what has to change in terms of the individual items or their weights should be informed by the changing patterns of consumer spending in Ghana. For example, in the Table, one may argue about the appropriateness of giving Communications a weight of only 0.31 percent if it is believed that this does not truly represent its relative importance in consumers' spending. The public could engage the GSS in a debate to bring about any deserved changes.

Single-Digit Inflation Versus the Cost of Living

The inflation debate has also focused on the apparent dichotomy between the single-digit inflation recorded since June 2010 and the real cost of living.

The fact is that because Ghana has had high inflation rates for a long period of time, this has cumulatively led to a high cost of living in the country. The increase in the cost of living has not been matched by a corresponding increase in wages and salaries or incomes. As a result, most people have become worse off in real terms. In fact, starting from the base year of 2002 for computing the current CPI series, the average price index rose from 100 to 396 as of end-April 2012. This shows an increase of 296 percent over a decade, which works out to an annual average increase of nearly 30 percent. Over this period, the annual average salary increase has been much less, thereby making workers worse off in real terms. Since inflation was even much higher in the past, it means that over a longer period of time, the cumulative increase in the cost of living has been much higher than the corresponding increase in wages and salaries.

The gap between incomes and the cost of living can be best illustrated with the real value (or purchasing power) of the minimum wage or with the income-poverty rate. The daily minimum wage is currently GH¢4.48, which works out to GH¢134 for a 30-day month. For anybody at the bottom of the pay ladder receiving this monthly income, we know from the prices of goods and services that it is not enough to pay for his basic needs like food, rent, transportation, utilities and communication. He might also be paying for other goods and services like clothing, healthcare and education. Millions of people in this country live below this income threshold either because they receive low incomes in their jobs or they may not even be employed and may be living on the largesse of relatives and friends. Taking it from the income-poverty angle, one arrives at a similar result. It is known that millions of Ghanaians live below US$2.00 a day, which is less than GH¢4.00- slightly below the daily minimum wage. Therefore, notwithstanding the fact that single-digit inflation has been attained, millions of Ghanaians struggle daily to make ends meet.

This is a situation that is not going to be ameliorated anytime soon, since there is a lot of catching up to do. The catching up requires two important conditions. The first condition is to sustain the low rate of inflation for a considerable length of time. On the one hand, this requires prudent macroeconomic policies to keep demand under control. On the other hand, it calls for policies that increase the economy's growth potential to ensure adequate supply of goods and services at all times. The second condition is to have labor productivity increase sufficiently to allow significant increases in wages and salaries without stoking inflation. This can be achieved through policies that improve human capital and labor skills.

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