

Has Ghana Taken Liberal Economic Policies too Far— and at What Cost?

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Abstract

Upon the advice of Western financiers who have provided assistance to Ghana for decades, the country has been implementing liberal economic policies that largely emphasise free markets, free trade, private enterprise and limited government. But are these policies suited to a developing country like Ghana? What has been the impact of these policies on the Ghanaian economy? Are there alternative policies to correct any negative effects of liberal policies in the country? This paper seeks answers to these questions. In general, it finds that Ghana may have taken liberal policies too far as these policies seem to be unsuited to less mature economies. In particular, the adoption of unbridled liberal policies has: i) perpetuated production of low value-added commodities; ii) inhibited industrialisation and transformation of the economy; iii) exacerbated macroeconomic imbalances; and iii) stifled growth. Based on the experiences of western countries in their early stages of development and that of more successful Asian countries, the paper recommends direct state intervention policies to unleash the country's growth potential.

Introduction

Ghana has for decades received financial assistance from western-based institutions and bilateral donors. The assistance is usually accompanied by liberal policy conditionalities that emphasise the superiority of free markets and private enterprise over-reliance on regulations and an active role for the state. Ironically, in the early stages of their development, western countries did not practise the very policies that they and their apologists now preach to Ghana and other African countries. They did not practise unbridled free market and private enterprise policies. They used the state to intervene extensively to regulate and provide support to their economies. The highly successful Asian countries like China, South Korea, Singapore, Taiwan, Malaysia and Indonesia are also known to have used the state rather than the private sector to drive their growth.

This paper examines the negative effects associated with a range of liberal policies that Ghana has been implementing under the aegis of the Washington-based Bretton Woods Institutions (BWIs) and proposes alternative policies to unleash the country's growth potential.

The costs of liberal policies and how to offset them

Ghana has been implementing a range of liberal policies over the decades. This paper focuses on some of the key ones relating to: i) product concentration; ii) open trade; iii) privatisation; iv) subsidies and other incentives; v) financial sector liberalisation; and vi) macroeconomic retrenchment.

Product concentration

Ghana and other African countries have swallowed ‘hook, line and sinker’ the suggestion by western financiers that they should continue to produce primary commodities, because they have “comparative advantage” in producing those commodities. But this suggestion is an erroneous interpretation of the “Theory of Comparative Advantage (TCA)” espoused by David Ricardo in the 19th Century. Ricardo proposed that a country should use its comparative advantage in whatever resource(s) that it may be endowed with to produce other goods more competitively. He did not mean that if an African country is endowed with natural resources, then it should just churn them out in their raw form and export them. Ricardo meant that you should use the natural resources that are your comparative advantage to produce other goods, especially industrial ones, more efficiently and competitively. Because we have accepted the erroneous interpretation of Ricardo, we have stuck to exporting our gold, bauxite, oil and gas in their primary forms to world markets that dictate the prices to us. This practice has perpetuated our de-industrialisation and impoverishment.

As a country, what we should be doing is to use our natural resource endowment to industrialise and transform our economy. We should use our gold to build jewellery industries. We should use our bauxite to build aluminium industries. We should use our oil and gas to build petrochemical industries. And we should use our vast arable land to develop crops that will feed agro-food industries. President Nkrumah embarked on the right path to use our gold, bauxite, manganese, iron ore and water resources to support Ghana’s industrialisation. But his strategy was curtailed after his overthrow, ironically, by the very western interests who are now advising us to abandon his strategy. We should return to Nkrumah’s strategy to exploit our natural resources and use them to support industrialisation of the economy. We should follow the example of the South East Asian Countries (SEAs) to diversify our economy through industrialisation. Our huge arable land has allowed us to acquire additional comparative advantage in commodities like cocoa, palm fruits and rubber. Taking as an example cocoa, which has been our major export commodity, the raw material world market is worth US\$10 billion. On the other hand, the chocolate market is worth over US\$100 billion—ten times as much! It certainly does not make economic sense to invest immense capital in producing cocoa only to export it in raw form. We should rather invest in industries that will transform the cocoa into finished products that will fetch us many times more in export earnings. Meanwhile, we sit on natural resources estimated to be worth over US\$12 trillion! We can progressively exploit our natural resources to transform our economy through industrialisation, as Ricardo was advocating. We cannot make progress as a country if we continue to export our resources in raw form or cede them to foreign investors under concession contracts from which we derive paltry benefits.

Open trade

Ghana has long been advised by its western financiers to keep an open trade policy. This implies eliminating quotas on most goods except those deemed essential for health and security reasons. It also involves reduction of tariffs on imports to the minimum. The argument used to support open trade policy is that it opens the economy to competition and gives consumers a choice. This all sounds good—at least in theory. However, the practical effect is to kill our infant and fledgling industries—and the economy. The irony is that western countries did not maintain open trade policies in the early stages of their development. Indeed, it was the pervasiveness of trade restrictions and the use of devaluations by western countries in the years through the Second World War to outcompete each other that led to the formation of the IMF in the first place. Therefore, for these countries to preach open trade to developing countries through their apologist-BWIs is preposterous, to say the least.

We are a developing country—not a mature one. And that is why we need to protect our infant and fledgling industries—and our economy. We should use both tariff and non-tariff instruments to “shield” our industries from undue competition from potential dumping-imports and allow them to flourish rather than wither. We should directly promote our exports through appropriate financial and institutional support systems—as western countries also do. We should push for an international trading system that is mutually fair and beneficial to all. The African Continental Free Trade Area (AfCFTA) is a good initiative that can elevate intra-African trade and contribute to catalyse the continent’s growth. However, it is important that the AfCFTA is shielded from potential intrusion from developed countries that may want to take advantage of the open continental trade system and generate similar economic costs, as do our individual open trade regimes.

Privatisation

President Nkrumah used the state to drive the Ghanaian economy after independence. He involved the state extensively in the development of industry and agriculture. After his overthrow, the country embarked on a progressive agenda of privatisation of state-owned enterprises (SOEs). Over the years, foreign private ownership of the economy, in particular, increased, especially in the extractives, services and technology sectors. The BWIs pushed us along this path, touting private enterprise as being more efficient than “statism”. But, new foreign owners of SOEs, motivated by profit, resorted to cost-cutting measures, with labour bearing the main brunt, which exacerbated the unemployment situation. Further, monopolistic and oligopolistic industries emerged, leading to non-competitive pricing policies. But, above all, the most damaging impact of privatisation is loss of indigenous ownership and control of our economy. In fact, our gross domestic product (GDP) and balance of payments (BoP) measures tend to be highly overstated since we include the benefits that accrue to foreign investors. If we strip our GDP of the portion that accrues to foreigners to arrive at gross national product (GNP), we would see that it is relatively modest. Similarly, our GNP per capita will be much smaller than our GDP per capita that is used to measure our relative richness on a global scale.

It is because of the foregoing reasons that we should take back control and ownership of our economy. The state should be back in the driving seat—not at the fringes of the economy. We require a state-driven industrialisation programme, with the state actively involved in the

entire value chain from infrastructure and other logistical support to production to marketing. The tremendous economic progress made by South East Asian countries was made on the back of strategic state-owned industrial conglomerates. Of course, it is necessary to put in place appropriate institutional frameworks to ensure that SOEs are managed efficiently. We have capacity locally to do this. Even where we lack local capacity, we can contract the services of foreign experts, but we should always ensure that the technology involved is appropriately transferred to Ghanaians. The ultimate goal of policy should be to maintain ownership of our economy, protect the national interest and maximise national welfare.

Subsidies and other incentives

Subsidies and other incentives are usually offered by states to consumers and producers, and they serve economic and social purposes. Subsidies and incentives entail fiscal costs that usually have to be financed from taxes. And because African countries usually face severe budget constraints, western donors who finance a chunk of their budgets often advocate the elimination of state subsidies and incentives in these countries.

However, subsidies and incentives by themselves are not a bad thing and cannot be completely dismissed as such. Usually, it is their application that may be called into question. For instance, if subsidies and incentives are applied universally, they may be wasteful and may not achieve the intended goals. An example is the universal subsidy on petrol that was applied in the past in Ghana. It was found to have encouraged the inefficient use of petrol. Moreover, it was found to have been more beneficial to the rich than the poor who may have been the intended target of the subsidy. In general, a state subsidy or incentive needs to be applied selectively to be useful—and even justified. For instance, selective consumer subsidies may be applied to food staples, rural energy, rural water, primary education, primary healthcare, and public transportation as a social safety net mechanism for the poor and vulnerable groups. These are common in even advanced countries; so why would they not be justified in developing countries that traditionally lack strong social protection systems? Selective producer subsidies and incentives may also involve cash payments to farmers, guaranteed agricultural prices, supply of fertilizer and improved seeds to farmers, tax rebates, tax holidays and other tax incentives targeted at strategic sectors of the economy such as agriculture and industry to elicit greater investment and output. These subsidies and incentives are also common in advanced countries. One important example is the EU's Common Agricultural Policy (CAP). The CAP provides direct income support to farmers to enable them to improve their productivity, ensure a stable supply of affordable food and promote jobs in farming, agro-food industries and associated sectors. We have a duty to provide subsidies and incentives to our farmers and our potentially viable infant industries. These may be provided in the form of subsidised credit, subsidised inputs, tax incentives, technology and services as needed to both industry and agriculture. The way to lessen the burden of subsidies and incentives on the budget is to levy discriminatory taxes on luxury goods and services used mainly by the rich to partly pay for them.

Financial sector liberalisation

Prior to 1983, Ghana's financial sector was strictly controlled and regulated. Bank registration was strictly regulated and restricted. Deposit rates were under-capped and lending rates were capped above. Bank lending to various sectors of the economy was regulated. Foreign exchange transactions were regulated and the exchange rate was controlled. The

purpose of these controls and regulations was to ensure that the financial sector was stable and that it served the interest of the economy well. The controlled system, however, did not serve its exact purposes. State banks were mismanaged and became financially distressed. Credit did not go to sectors of the economy where it was intended to go. The foreign exchange system was abused and black-market activities thrived. As a result of these lapses, it was decided to liberalise the financial sector starting from 1983. Several state banks were privatised. Bank registration was opened up. Interest rate controls were lifted, as was directed sectoral lending. The foreign exchange market was liberalised, and private forex bureaux were licensed to deal in foreign exchange alongside banks. Liberalisation of the financial sector has, however, come with costs. Competition expected from opening up the banking sector has not materialised. Deposit rates remain depressed along with prohibitively high lending rates. Banks shun lending to agriculture and small- and medium-sized enterprises (SMEs) because they are deemed risky, although they form the backbone of the economy. The liberalised foreign exchange market has not been backed by policies to transform the economy and underpin the exchange rate, which has been rendered defenceless and in perpetual decline.

There is a need for policies to counter the adverse effects of the liberalisation of the financial sector. We are not calling for restoration of the pre-1983 controls. What we need is a well-regulated financial sector that is stable and is able to play the intermediary role of channelling savings to investors. First, the central should guide banks' interest rates to be in close alignment with the Monetary Policy Rate (MPR) and also to be mutually acceptable to both banks and their customers. The Ghana Reference Rate (GRR) mechanism is a good beginning for reining in lending rates and aligning them with the MPR, but the mechanism needs to be progressively refined to make it more effective. Second, in the absence of directed sectoral lending, the central bank should create parallel lending schemes to cater for the priority agricultural and industrial sectors and SMEs. This could be done through the existing Agricultural Development Bank and National Investment Bank or by creating a new National Development Bank. Lending by these banks should be subsidised by the central bank to enable the beneficiaries operate competitively. Third, the liberalised foreign exchange market should be backed by policies to bridge the gap between foreign exchange demand and supply so as to ensure a durably stable exchange rate. The bottom line is that the economy should be transformed through industrialisation, leveraging our natural resource endowment so that exports can be increased, and imports curtailed.

Macroeconomic retrenchment

Ghana's economy has long been plagued by high fiscal deficits, high inflation, currency instability and high external deficits. But these statistics reflect structural supply-demand imbalances in the economy, which is typical of developing countries. In their policy advice to deal with this problem, the BWIs have invariably prescribed "economic retrenchment," which entails cuts in government spending, hikes in taxes, restrictions in bank credit, hikes in interest rates and currency devaluations. This policy menu reflects the ideology of the BWIs that the economic imbalances are fuelled by excess demand, which has to be reined in. The problem with this type of policy prescription, however, is that it fails to recognise the fact that developing countries usually face structural, supply-side defects that fuel their macroeconomic imbalances. Failing to recognise the fundamental source of the problem and wrongly prescribing the demand-based approach, tends to aggravate the imbalances by holding down the supply side and growth of the economy.

Policies to deal with economic imbalances should rather focus on supply and growth constraints in the economy. These constraints encompass deficiencies in physical capital, technology, human capital and financial capital. Addressing these deficiencies should be a long-term goal. This is a goal that is worth pursuing in order to avoid resorting to growth-inhibiting, demand-management policies often prescribed by the BWIs. We cannot stress enough the need to use our natural resources to industrialise and transform the economy. By so doing, the chronic macroeconomic imbalances that rather reflect underlying structural defects in the economy would be permanently eliminated.