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Ghana: Selected Issues

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GHANA

Selected Issues

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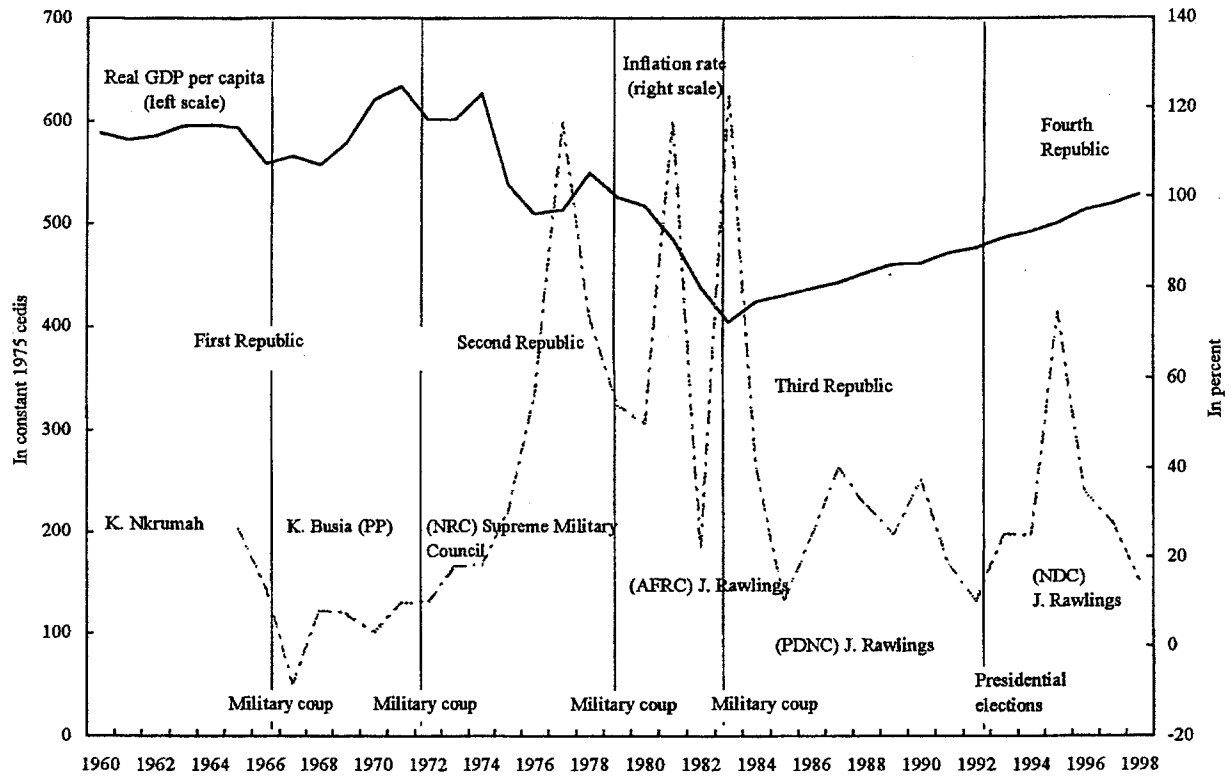
I. GROWTH, SAVINGS AND INVESTMENT¹

A. Introduction

1. The period following the military coup of 1966 that overthrew Kwame Nkrumah, Ghana's first president, was characterized by centralized economic management and inward-looking development strategies that led to declining per capita GDP and soaring inflation rates (Figure 1). The deterioration of the terms of trade, fiscal imbalances, rising inflation, and political unrest in the early 1980s led the country to the worst economic crisis since independence.
2. By 1983 real per capita GDP was close to half its level in the late 1960s. Popular support for the government had waned, and a group of young officers led by Lieutenant Jerry Rawlings took over power. The period from 1983 to 1991 was marked by a process of transformation from an administrative system of economic management to a market-oriented system. Beginning in 1984, the implementation of the Economic Reform Program (ERP) succeeded in improving output levels and increasing private sector activity and investment, thus making Ghana one of Africa's best performing economies.
3. The year 1992 was another watershed in Ghana's political history. A new constitution was adopted in April, and presidential and parliamentary elections were held for the first time since 1965. The election period was characterized by sizeable government spending, which worsened macroeconomic imbalances and rekindled inflation. Political unrest in the early years of the new democratic system led to a hiatus in economic reforms. As a result, inflation rates increased and the pace of recovery slowed down.
4. In recent years, Ghana adopted an economic strategy designed to improve the environment for private sector development and reduce poverty. In this context, the country has returned to a path of macroeconomic stability and output growth, which appears to have established the basis for a sustained economic development in the years to come.
5. Against the background of these political and economic events, this chapter reviews trends in GDP and other macroeconomic variables since independence. It assesses the performance of the different sectors of the economy and expenditure categories. It identifies structural constraints and possible sources of sustained output in future years. The chapter is organized as follows: Section B presents and discusses the trends in the main production sectors and their potential for further development. Section C reviews trends in investment and savings patterns, the nature of the financing of the gap, and the developments in the external sector; and Section D briefly reviews the pattern of per capita GDP and concludes.

¹ Prepared by Luisa Zanforlin.

Figure 1. Ghana: Real GDP Per Capita and Inflation, 1960-98.



B. Sources of Output

Overview

6. In spite of the recent growth in the mining and construction sector, Ghana's economy remains dominated by the agriculture sector. The relatively high share of agriculture in the Ghanaian economy and the low share of manufactured output suggest that Ghana is still at the initial stage of industrialization, even compared with other countries in the region.² Mining has been the fastest growing activity with the metal and cement industries following closely and providing the base for industrial development. Infrastructural bottlenecks appear to be a key constraint for growth. For example, aluminum and cement production has been suffering from the limited production capacity of the electricity-generating industry, and the export industry is severely undermined by the poor condition of the transport sector.

² In Côte d'Ivoire, for example, its closest neighbor, the share of agriculture in value added is close to half that in Ghana, while manufacturing represents a much larger share of output.

Sectoral Composition of GDP

7. Ghana has a predominantly rural economy with agriculture accounting for about 40 percent of the value added (Table 1). The rural sector is relatively large, even in comparison with other countries in Sub-Saharan Africa (SSA), although in terms of extension of the agricultural land, Ghana is not among the largest countries (Table 2). The services sector has historically been the second-largest sector, accounting for about 30 percent of GDP, with transport services and retail trade among the most important activities. The share of services in value added has been declining. The industrial sector has seen rapid growth in recent times, as its sectoral share reached one-fourth of value added in 1997, with mining and construction among the fastest-growing activities.

Table 1. Ghana: Gross Domestic Product by Sectors, 1975-98
(In percent of nominal GDP)

| | 1975 | 1985 | 1993 | 1998 |
|--|-------|-------|-------|-------|
| Agriculture | 47.7 | 44.6 | 36.9 | 36.0 |
| Agriculture and livestock | 29.7 | 34.3 | 25.7 | 22.5 |
| Cocoa production and marketing | 10.9 | 5.4 | 2.8 | 4.9 |
| Forestry and logging | 5.6 | 3.3 | 2.8 | 3.6 |
| Fishing | 1.5 | 1.5 | 5.7 | 5.0 |
| Industry | 21.0 | 16.6 | 24.8 | 25.3 |
| Mining and quarrying | 2.0 | 1.1 | 5.5 | 5.2 |
| Manufacturing | 13.9 | 11.5 | 9.4 | 9.0 |
| Electricity and water | 0.6 | 1.2 | 2.6 | 2.6 |
| Construction | 4.5 | 2.8 | 7.4 | 8.5 |
| Services | 29.5 | 38.4 | 27.5 | 28.2 |
| Transport storage and communication | 3.9 | 5.3 | 4.3 | 4.1 |
| Wholesale and retail trade, restaurants and hotels | 12.2 | 24.4 | 5.8 | 6.6 |
| Finance, insurance, real estate and business | 5.2 | 2.3 | 4.1 | 4.2 |
| Government services | 8.2 | 6.3 | 10.6 | 9.9 |
| Community, social and personal services | 1.0 | 1.6 | 1.8 | 2.4 |
| Produces of private nonprofit services | 0.5 | 0.1 | 0.9 | 0.9 |
| Bank charges | -1.4 | -1.6 | ... | ... |
| Indirect taxes | 1.8 | 1.4 | 10.7 | 10.5 |
| GDP at market prices | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Ghana Statistical Services.

Table 2. Top Ten Countries by Agriculture in Sub-Saharan Africa, 1970-94

| Agricultural Land (Hectares) | | Value Added in Agriculture (In percent of nominal GDP) | | | |
|---------------------------------|-------------|---|------|----------------------|------|
| 1994 | | 1970 | | 1994 | |
| Sub-Saharan Africa | .. | Sub-Saharan Africa | 26.6 | Sub-Saharan Africa | 25.4 |
| Ghana | 12,900,000 | Ghana | 46.5 | Ghana | 38.8 |
| Sudan | 122,975,000 | Rwanda | 66.2 | Congo, Dem. Rep. | 65.9 |
| South Africa | 97,000,000 | Mali | 66.2 | Ethiopia | 54.8 |
| Nigeria | 72,700,000 | Niger | 64.9 | Guinea-Bissau | 52.3 |
| Angola | 57,500,000 | Somalia | 59.4 | Central African Rep. | 50.1 |
| Chad | 48,256,000 | Uganda | 53.7 | Uganda | 50.0 |
| Mozambique | 47,180,000 | Guinea-Bissau | 47.5 | Burundi | 49.7 |
| Somalia | 44,020,000 | Chad | 47.1 | Equatorial Guinea | 49.1 |
| Mauritania | 39,458,000 | Malawi | 44.0 | Tanzania | 46.3 |
| Namibia | 38,750,000 | Sudan | 42.9 | Chad | 44.9 |
| Tanzania | 38,675,000 | Nigeria | 41.3 | Rwanda | 43.5 |

Sources: Ghanaian authorities; World Bank; and staff calculations.

Agriculture

8. Cereals are the main agricultural crop in Ghana, amounting to about 20 percent of GDP; maize accounts for 60 percent of cereals, and guinea corn, rice and millet account for the remainder. Other crops are cassava and yams, and cashew nuts. Cultivation of sunflower and tropical fruits, such as pineapples, has also increased recently, especially because of rising demand for their export to European countries.

9. Agricultural production barely increased during the 1970s and then contracted sharply during the years of economic crisis (1979-83). With the beginning of the ERP in 1983, production recovered and continued to increase throughout the second half of the 1980s. In particular, the area under cultivation increased steadily from the beginning of this period through 1994. The increase in acreage enabled production to expand, in spite of the decline in the consumption of fertilizers following the sharp devaluation of the cedi in the beginning of the ERP. Agricultural experts maintain that the sector still has a considerable unexploited potential that, if fully taken advantage of, would further expand crop production and thus provide a solid base for future output expansion.

10. Of the activities in the agricultural sector, **fishing** has been one of the fastest growing, with catches steadily increasing since 1986. The share of fishing in value added doubled from 1975 to 1993, according to the latest estimates. In the most recent years, however, growth in this sector has been sluggish, apparently because of the over exploitation of some pelagic species.

11. Although accounting for only 3 percent of total valued added, **cocoa** continues to be among the main export commodities of the Ghanaian economy and one of its main sources of

foreign exchange. Cocoa production fell steadily throughout the 1970s and reached an all time low of 166,000 tons in 1984, with volumes less than half those in the early 1970s. After years of neglect, cocoa trees aged and low prices paid to the cocoa farmers for the crops induced smuggling of cocoa to Côte d'Ivoire. With the onset of the ERP, the new government saw in the development of cocoa production the main driving force behind Ghana's return to steady growth. Thus, a Cocoa Rehabilitation Program was implemented, which included re-planting and maintenance of trees, while the price paid to farmers increased. This policy was successful in reversing the sector's decline and increasing volumes considerably. The cocoa crop is expected to reach 500,000 tons by 2004/05—a production volume comparable with that in 1964/65.

Industry

12. Industrial output has increased steadily over recent years, although at a slow pace. **Manufacturing** was traditionally the largest sector of economic activity outside agriculture, with a share in value added of about 14 percent in 1975, well within the average for Sub-Saharan African countries. However, its share has been declining, and represented only about 9 percent of GDP in 1998, small by comparison with other Sub-Saharan countries (Table 3). This sector has been the slowest to recover during the reform period. The average production in 1990 was only about 60 percent of its level in 1977, and output in all manufacturing industries, with the exception of cement and iron, was below its level in the 1970s. According to estimates of the Ghana Statistical Service (GSS), the capacity utilization of the manufacturing industry was only about 40 percent in 1990, further evidence of the slow growth in the sector. Food processing and textile manufacturing in 1990 were still less than 60 percent of their volume in 1977.

Table 3. Top Ten Countries by Manufacture in Sub-Saharan Africa, 1965–95.
(In percent of GDP)

| 1965 | | 1975 | | 1985 | | 1995 | |
|--------------------|------|--------------------|------|--------------------|------|--------------------|------|
| Sub-Saharan Africa | 14.1 | Sub-Saharan Africa | 14.4 | Sub-Saharan Africa | 14.2 | Sub-Saharan Africa | 14.9 |
| Ghana | 9.8 | Ghana | 13.9 | Ghana | 11.5 | Ghana | 9.6 |
| South Africa | 23.9 | South Africa | 23.7 | South Africa | 23.1 | Swaziland | 34.4 |
| Zimbabwe | 19.7 | Zimbabwe | 23.5 | Zimbabwe | 22.9 | Zambia | 27.0 |
| Mauritius | 14.3 | Burkina Faso | 19.8 | Zambia | 22.9 | South Africa | 24.3 |
| Botswana | 13.1 | Chad | 19.2 | Mauritius | 20.6 | Mauritius | 23.7 |
| Burkina Faso | 12.2 | Senegal | 16.4 | Swaziland | 16.7 | Zimbabwe | 21.8 |
| Senegal | 11.8 | Mauritius | 16.3 | Chad | 15.9 | Burkina Faso | 19.8 |
| Kenya | 11.5 | Zambia | 15.9 | Burkina Faso | 15.3 | Burundi | 19.2 |
| Chad | 9.7 | Malawi | 13.1 | Rwanda | 15.0 | Malawi | 18.7 |
| Togo | 9.6 | Rwanda | 13.1 | Malawi | 14.5 | Lesotho | 16.4 |
| Cameroon | 9.5 | Benin | 12.2 | Mauritania | 12.9 | Chad | 16.3 |

Sources: Ghanaian authorities; World Bank; and staff calculations.

13. The fastest-growing industries have been the cement, petroleum, and metal industries, together with iron production. The privatization of the iron sector in the early 1990s appears to have generated substantial benefits, as iron production, which in 1990 had declined to about 5 percent of its level in 1977, increased its volume sixfold between 1990 and 1996. Sawn wood production experienced strong growth in the second part of the 1980s and through the early 1990s, before slowing down significantly because of the ban on exports of logs and other environmental constraints on the industry. Aluminum production picked up immediately after the beginning of the ERP, although by 1992 output was still below its 1980 levels. More recently, export volumes have been rising steadily, indicating production has been increasing.

14. In the **mining** sector, production increased in the second half of the 1980s, reaching 6 percent of GDP in 1997, even though the composition of output changed. Extraction of diamonds, which in the 1970s was Ghana's second largest mining industry in volume terms, virtually disappeared in the early 1980s. By 1990, the average index for mining output had returned to its 1977 value, as strong increases in the production of bauxite and manganese pushed these volumes to levels one-third higher than those attained in the late 1970s. Strong growth in the mining sector continued in the 1990s, with the average production index increasing by 150 percent in the first six years. Most of this increase is explained by the doubling of the gold production, associated with the privatization of the Ashanti Goldfields Company and the strong investment in the sector thereafter. However, iron, bauxite, and manganese production, helped partly by the recent privatization in the sector, have also achieved rapid growth, increasing by almost 50 percent in the period 1990-96. This process has also raised the share of mining sector in total exports, as well as its value-added share, with gold becoming a main source of foreign currency earnings.

15. Growth in the construction industry, typically proxied by growth in the production of cement, did not recover until the late 1980s. However, since the beginning of the 1990s, output volumes have grown at a sustained rate, with volumes more than doubling between 1990 and 1996. In effect, the share of construction in GDP grew from 5 percent in 1975 to 8 percent in 1997. The current trends in the construction sector are the main force driving the observed growth rates in fixed capital formation.

16. A drought in 1998, which lowered the water levels in the Akosombo dam below ordinary production levels, caused major blackouts throughout the country. These events made the structural problems and the capacity constraints in **electricity** production evident.³

³ The drought also highlighted some structural problems with the tariff-setting system of public utilities: in spite of the increases in January 1998, electricity in Ghana was among the cheapest in the region, and the Volta River Authority, the region's main producer, was accumulating losses. However, since 1998, the government has been implementing an extended program of tariff increases to bring prices more in line with regional averages and to restore economic viability to the electricity company.

The government had anticipated these constraints, and, since the early 1990s, has been carrying out a series of publicly financed projects aimed at increasing the electricity generating capacity in the country. The largest single consumer of electricity is VALCO, a U.S.-owned aluminum firm that buys about 60 percent of total production; the remainder has been directed mainly to the manufacturing sector, as shown by a 60 percent correlation between the manufacturing production index and electricity volumes. Electricity generation has been insufficient to meet the country's needs since 1994, when Ghana ceased to be a net exporter of electricity. Household and private consumption has been increasing steadily, putting pressure on production. Electricity generation grew to about 3 percent of total value added in 1998, an increase of 250 percent with respect to 1975. However, production has not been able to keep pace with the growth in the population; at end-1995, total consumption per capita had scarcely reached its volume in 1971.

Transport and services

17. The services sector has contracted slightly over the past decades. Recently, GSS rebased its estimates of GDP by sector. During this process it reestimated the share of services in value added, which now shows virtually no change between 1975 and 1996 (Table 1). The main reasons behind the delays in the development of the sector appear to be infrastructural constraints.

18. Transportation as a share of value added has increased by only about ½ percentage point since 1975. The sector still experiences substantial structural problems. In fact, based on an examination of detailed statistics, it is surprising the sector has grown at all. The volume of passengers in railways is less than a third of the level in the 1960s, while total cargo volumes transported by railway has almost halved. Also, in spite of the numerous rehabilitation programs, roads have been badly maintained. Mining sector exporters have been complaining that stocks have accumulated while waiting to be transported to the ports for export. Even traffic volumes at the airport have grown slowly. Nevertheless, activity at the ports has been gradually increasing—a positive spillover of the development of foreign trade—as volumes loaded and unloaded at the main ports are about one-fourth higher than in 1970. Growth of import volumes has substantially exceeded export volumes.

19. No specific estimate of **financial services** was available. However, early the 1990s also marked the beginning of a new era in the banking sector, as privatization and restructuring operations increased the volume of financial transactions.

C. Investment and Savings

Investment

20. The share of investment in GDP has historically been lower in Ghana than in other Sub-Saharan African countries. In 1970, when the investment to GDP ratios in Gabon and Zambia were averaging about 30 percent, the investment rate in Ghana was just above 10 percent of GDP. It further declined amidst the subsequent economic crisis, reaching 6 percent in 1980. The recovery, however, has been remarkable, and by 1996 the share of investment in GDP had risen to about 20 percent, a magnitude close to that of the ten countries with the highest shares in the region (Tables 4 and 5). The investment has been rising in tandem with the external current account, which seems to indicate that Ghana is running "structural current account deficits" associated with a buildup of fixed capital (Figure 2).

Table 4. Ghana: Gross Domestic Product by Expenditure Category, 1975-98
(In percent of nominal GDP)

| | 1975 1/ | 1985 | 1993 | 1998 1/ |
|---|---------|-------|-------|---------|
| Consumption | ... | 92.4 | 93.4 | 87.7 |
| Government | 24.5 | 10.2 | 14.7 | 10.3 |
| Private sector | ... | 82.2 | 78.7 | 77.4 |
| Total investment | ... | 9.5 | 22.2 | 24.7 |
| Gross fixed capital formation | 12.4 2/ | 9.5 | 23.8 | 23.6 |
| Inventories | ... | 0.0 | -1.6 | 1.1 |
| Foreign balance | -2.1 | -1.9 | -15.6 | -12.4 |
| Exports of goods and nonfactor services | 20.2 | 9.6 | 17.9 | 34.3 |
| Imports of goods and nonfactor services | -22.4 | -11.6 | -33.5 | -46.7 |
| Gross domestic expenditure | 124.5 | 101.9 | 115.6 | 112.4 |
| Gross domestic product | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Ghana Statistical Service.

1/ Estimated.

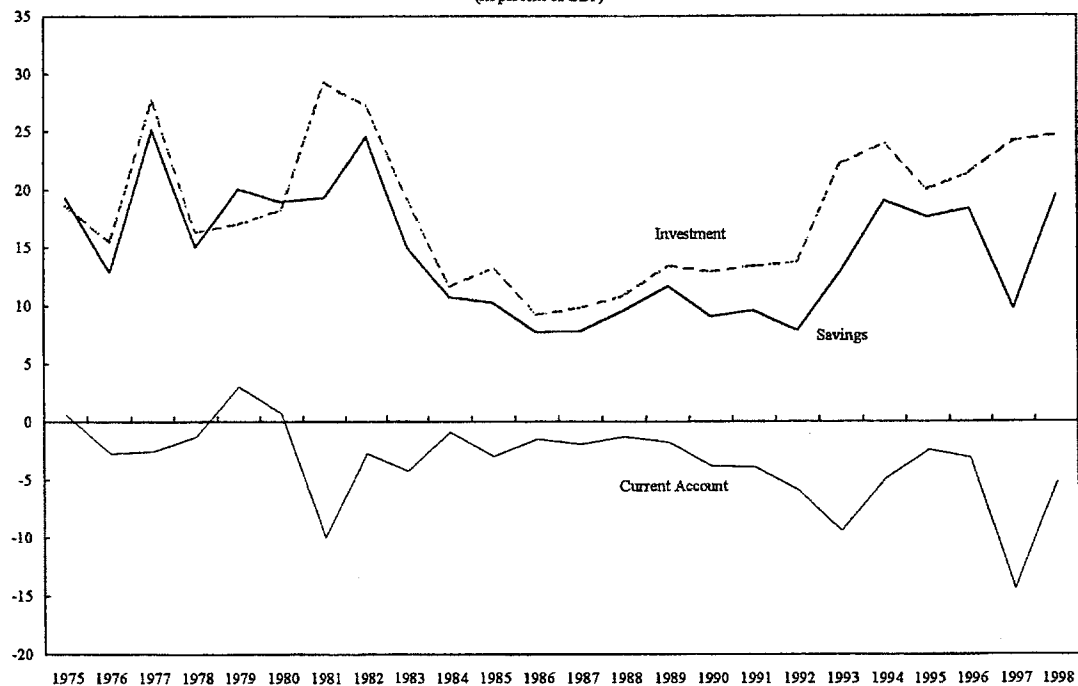
2/ Public sector only.

Table 5. Top Ten Countries by Investment-to-GDP Ratio in Sub-Saharan Africa, 1970-96
(In percent)

| 1970 | | 1980 | | 1990 | | 1996 | |
|---------------|------|-----------------------|------|-----------------------|------|-------------------|-------|
| Ghana | 12.0 | Ghana | 6.1 | Ghana | 14.4 | Ghana | 22.0 |
| Gabon | 30.4 | Somalia | 43.1 | Lesotho | 71.4 | Equatorial Guinea | 113.5 |
| Zambia | 29.1 | Lesotho | 40.3 | Sao Tome and Principe | 57.2 | Lesotho | 104.3 |
| Botswana | 27.1 | Seychelles | 36.5 | Mozambique | 44.6 | Congo, Rep. | 60.7 |
| South Africa | 24.7 | Sao Tome and Principe | 34.2 | Cape Verde | 43.1 | Mozambique | 48.3 |
| Cote d'Ivoire | 20.7 | Congo, Rep. | 32.9 | Equatorial Guinea | 38.5 | Cape Verde | 33.5 |
| Kenya | 19.7 | Mauritania | 31.3 | Botswana | 31.8 | Mali | 26.5 |
| Zimbabwe | 16.2 | Botswana | 30.2 | Guinea-Bissau | 30.9 | Eritrea | 26.4 |
| Mali | 14.0 | Comoros | 28.5 | Mauritius | 30.6 | Burkina Faso | 26.0 |
| Congo, Dem. | 13.6 | Niger | 28.3 | Togo | 25.3 | Mauritius | 24.9 |
| Uganda | 13.3 | Swaziland | 28.3 | Seychelles | 22.7 | Botswana | 24.1 |

Sources: IMF and World Bank databases.

Figure 2. Ghana: Savings, Investment and Current Account, 1975-98
(In percent of GDP)



21. The productivity of investment in Ghana, although low by international standards, appears to have been relatively high compared to the Sub-Saharan African average, at least in the past two decades: investment has accounted for 15 percent to 20 percent of the increase in output, a productivity level among the highest in the region (Table 6).

Table 6. Top Ten Countries in Productivity of Capital in Sub-Saharan Africa, 1970-95 1/

| 1970-75 | | 1975-80 | | 1980-85 | | 1985-90 | | 1990-95 | |
|---------------|------|---------------|------|--------------|------|-----------------------|------|-------------------|------|
| Ghana | 18.4 | Ghana | -8.0 | Ghana | -6.7 | Ghana | 20.4 | Ghana | 14.9 |
| Botswana | 48.5 | Somalia | 36.4 | Congo, Rep. | 36.9 | Botswana | 31.2 | Equatorial Guinea | 27.2 |
| Lesotho | 42.3 | Botswana | 29.2 | Botswana | 32.6 | Chad | 28.8 | Uganda | 21.3 |
| Gabon | 36.6 | Rwanda | 28.9 | Cameroon | 23.0 | Swaziland | 28.6 | Mozambique | 18.7 |
| Kenya | 27.4 | Mali | 28.2 | Zimbabwe | 18.5 | Mozambique | 23.6 | Mauritius | 15.8 |
| Mauritius | 23.6 | Cameroon | 25.9 | Rwanda | 14.8 | Mauritius | 22.9 | Botswana | 14.3 |
| Côte d'Ivoire | 23.5 | Cote d'Ivoire | 25.5 | Burundi | 11.2 | Sao Tome and Principe | 20.4 | Gambia, The | 13.6 |
| Congo, Dem. | 16.1 | Mauritius | 22.0 | Swaziland | 11.1 | Nigeria | 20.2 | Swaziland | 13.3 |
| South Africa | 14.7 | Lesotho | 21.9 | Congo, Dem. | 9.5 | Burundi | 18.7 | Guinea | 13.0 |
| Zambia | 11.2 | Malawi | 18.6 | Kenya | 9.4 | Seychelles | 18.6 | Nigeria | 12.7 |
| Rwanda | 10.9 | Kenya | 17.0 | Burkina Faso | 9.2 | Kenya | 18.5 | Benin | 12.0 |

Source: Ghanaian authorities; World Bank and IMF databases; and staff estimates.

1/ Calculated as the ratio of the average rate of GDP growth to average investment, in real terms calculated at 1985 constant dollars.

22. The share of public sector investment has also been declining steadily through the years of the recovery program, dropping to 10 percent in 1996—about 50 percent of total investment, and a reduction of one half with respect to its levels in the 1960s. This development is a positive sign of the gradual withdrawal of the public sector from economic activity and the rising importance of the private sector in economic development.

Domestic Savings

23. Because of political uncertainty, gross domestic savings declined from the beginning of the 1970s to 1996. This trend caused a considerable increase in Ghana's foreign borrowing, in particular during the early 1980s and early 1990s. Low private savings, together with high levels of government expenditures, have been the main factors behind the rise in foreign borrowing. In 1970, Ghana's domestic savings accounted for about 13 percent of GDP, about one-third below the Sub-Saharan African average, and did not rise again above that level until 1996. However, in more recent years, the economic recovery has been strong and domestic savings levels are now very close to the average for Sub-Saharan African countries (Table 7). The continued efforts of the government to consolidate its fiscal position have placed domestic savings on an upward trend.

Foreign Savings

24. As in many developing countries, the current account in Ghana has shown a structural deficit, which has caused the buildup of foreign debt. However, the good macroeconomic performance during the second half of the 1980s has meant that aid flows, including from multilateral institutions, have been considerable. Because of the large share of multilateral lending, Ghana has been able to finance its increase in investment at

Table 7. Top Ten Countries by Gross Domestic Savings in Sub-Saharan Africa, 1970-95

(In percent of GDP)

| | 1970 | | 1980 | | 1990 | | 1995 |
|-----------------------|------|--------------------|------|--------------------|------|--------------------|------|
| Sub-Saharan Africa | 19.2 | Sub-Saharan Africa | 23.4 | Sub-Saharan Africa | 18.0 | Sub-Saharan Africa | 17.1 |
| Ghana | 12.8 | Ghana | 4.9 | Ghana | 5.5 | Ghana | 9.9 |
| Zambia | 45.1 | Gabon | 60.6 | Seychelles | 37.7 | Angola | 54.0 |
| Gabon | 43.7 | Namibia | 38.9 | Gabon | 36.9 | Gabon | 42.1 |
| Liberia | 42.0 | South Africa | 36.5 | Botswana | 36.2 | Botswana | 38.2 |
| Swaziland | 31.3 | Botswana | 35.7 | Angola | 29.7 | Congo, Rep. | 27.8 |
| Mauritania | 29.7 | Congo, Rep. | 35.7 | Nigeria | 29.4 | Equatorial Guinea | 25.3 |
| Côte d'Ivoire | 29.2 | Nigeria | 31.4 | Mauritius | 23.6 | Mauritius | 22.7 |
| South Africa | 26.8 | Liberia | 27.3 | Zimbabwe | 23.4 | Nigeria | 20.9 |
| Togo | 25.9 | Seychelles | 27.1 | South Africa | 23.1 | Seychelles | 20.7 |
| Kenya | 23.6 | Zimbabwe | 26.9 | Congo, Rep. | 21.7 | Cameroon | 20.6 |
| São Tomé and Príncipe | 17.7 | Togo | 23.2 | Cameroon | 20.9 | Côte d'Ivoire | 18.9 |

Sources: World Bank and IMF databases.

concessional rates, maintaining the ratio of debt service to GNP at the average for Sub-Saharan African countries, even though the level of foreign debt to GNP is high in Ghana with respect to other countries in the region (Table 8).⁴

Table 8. Ghana: Debt Service and Aid, 1975-95

| | 1975 | 1980 | 1985 | 1990 | 1995 |
|-------------------------------------|------|------|------|------|------|
| Debt service as a percentage of GNP | | | | | |
| Sub-Saharan Africa | 1.2 | 2.5 | 6.2 | 4.7 | 3.9 |
| Ghana | 1.9 | 2.4 | 2.2 | 3.5 | 4.2 |
| Aid as a percentage of GNP | | | | | |
| Sub-Saharan Africa | .. | .. | .. | 6.3 | 5.3 |
| Ghana | 4.3 | 4.4 | 9.8 | 10.8 | 10.5 |
| Aid as a percentage of investment | | | | | |
| Sub-Saharan Africa | .. | .. | .. | 32.6 | 27.8 |
| Ghana | 76.6 | 45.4 | 66.3 | 56.8 | 55.2 |
| Per capita aid | | | | | |
| Sub-Saharan Africa | .. | .. | .. | 30.9 | 26.3 |
| Ghana | 17.8 | 15.5 | 37.9 | 38.3 | 37.3 |

Source: World Bank, Global Finance Indicators.

⁴ Comparable cross-country statistics are compiled in the World Bank's Global Finance Indicators database and calculated with respect to GNP.

25. Sizable aid flows into Ghana, have helped finance domestic expenditure in general, and domestic investment in particular. Indeed, recently domestic investment and aid flows have shown a strong positive correlation. In 1997, per capita aid averaged about US\$50, twice the amount for the average Sub-Saharan country and equivalent to about one third of all imports, or about one half of total investment. Aid directed to the central government accounted for 20 percent of total government expenditure. Although it is not possible to show a direct relationship between growth and the extent of foreign aid, the correlation between investment levels and aid flows is a positive indication of the favorable impact of aid flows on macroeconomic performance (Figure 3).

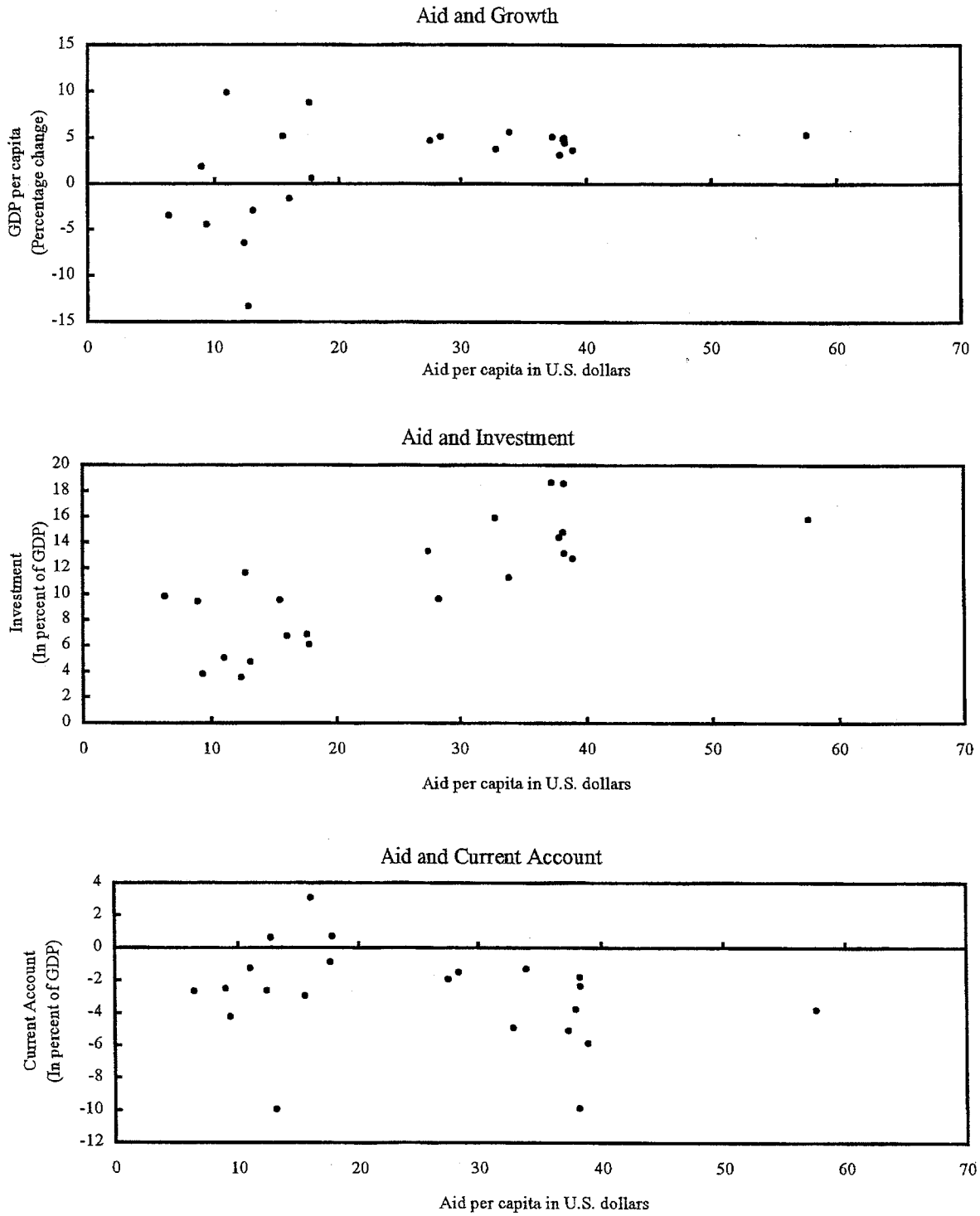
External Sector

26. Historically Ghana has had a small, open economy, with about one-fourth of GDP exported and about one-third imported. The export sector was the most important for the economy until development policies turned inward looking in the 1970s. The nationalistic policies and centralized economic management shifted attention away from the export sector, and the export share in GDP declined throughout the 1970s. In 1983, the new government restored the export sector, and in particular the cocoa industry, as a driving force for economic development. The exchange rate was devalued at the beginning of the ERP, and rehabilitation and restructuring programs were initiated, in particular in the cocoa, gold, and timber sectors. By the end of 1996, export volumes had returned to their level of the early 1970s. However, the much faster pace of import growth throughout the period has meant that the economy has become more and more dependent on foreign financing (Figure 4).

Exports. Until the beginning of the 1990s cocoa, gold, and timber, together with aluminum, represented about 90 percent of all commodities exported. In the 1950s and 1960s, Ghana was the world's largest cocoa producer; production levels were above 500,000 tons and were the main source of foreign exchange, accounting for 70 percent of total exports. The decline in production caused a contraction of exports that continued until the early 1990s, reducing export share to 20 percent. The beginning of the 1990s marked a change in government policies toward the cocoa sector and allowed cocoa exports to rise again, reaching more than a third of total exports. While earnings from cocoa were declining, gold exports rose steadily. In 1967, gold represented a relatively small share of exports—around 10 percent. Production increased during the 1980s, responding to the increases in world prices. By 1994, gold was the major earner of foreign exchange, accounting for 35 percent of exports. Exports of timber were marginal until the beginning of the 1990s, when international prices rose markedly. This price hike led exports to increase rapidly, but the ban of log exports for environmental reasons has slowed the growth of the industry considerably since 1995. Exports of nontraditional commodities, such as palm oil, fresh fruits, and natural rubber, which did not reach 1 percent of total exports in 1980, have been rapidly growing, accounting for 23 percent of the total exports to Europe by 1997.⁵

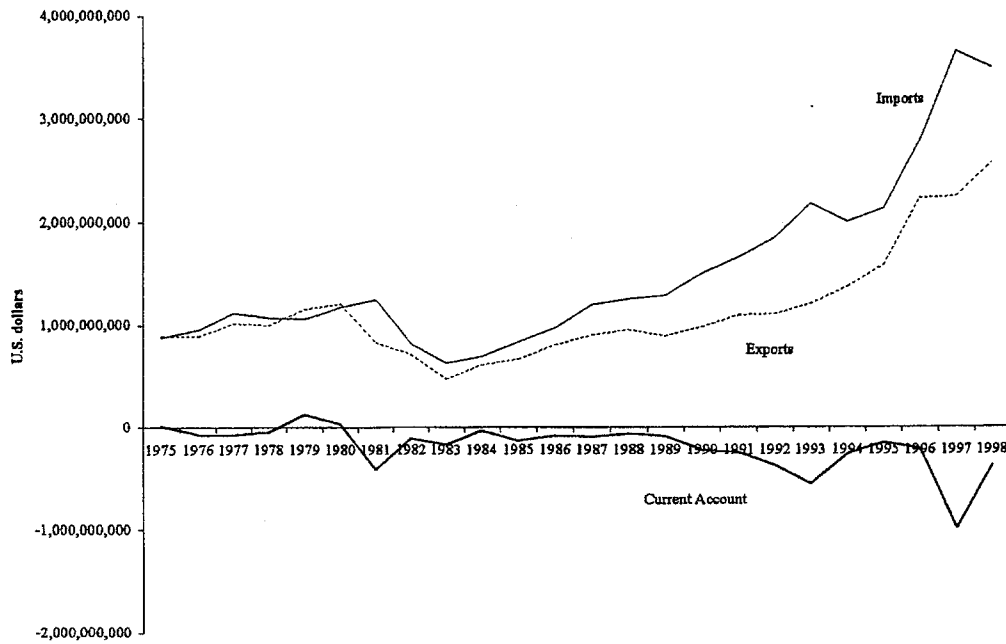
⁵ Total exports to Europe account for about 60 percent of total exports.

Figure 3. Ghana: Aid Flows, 1975-96



Sources: Ghanaian authorities; and World Bank and IMF staff calculations.

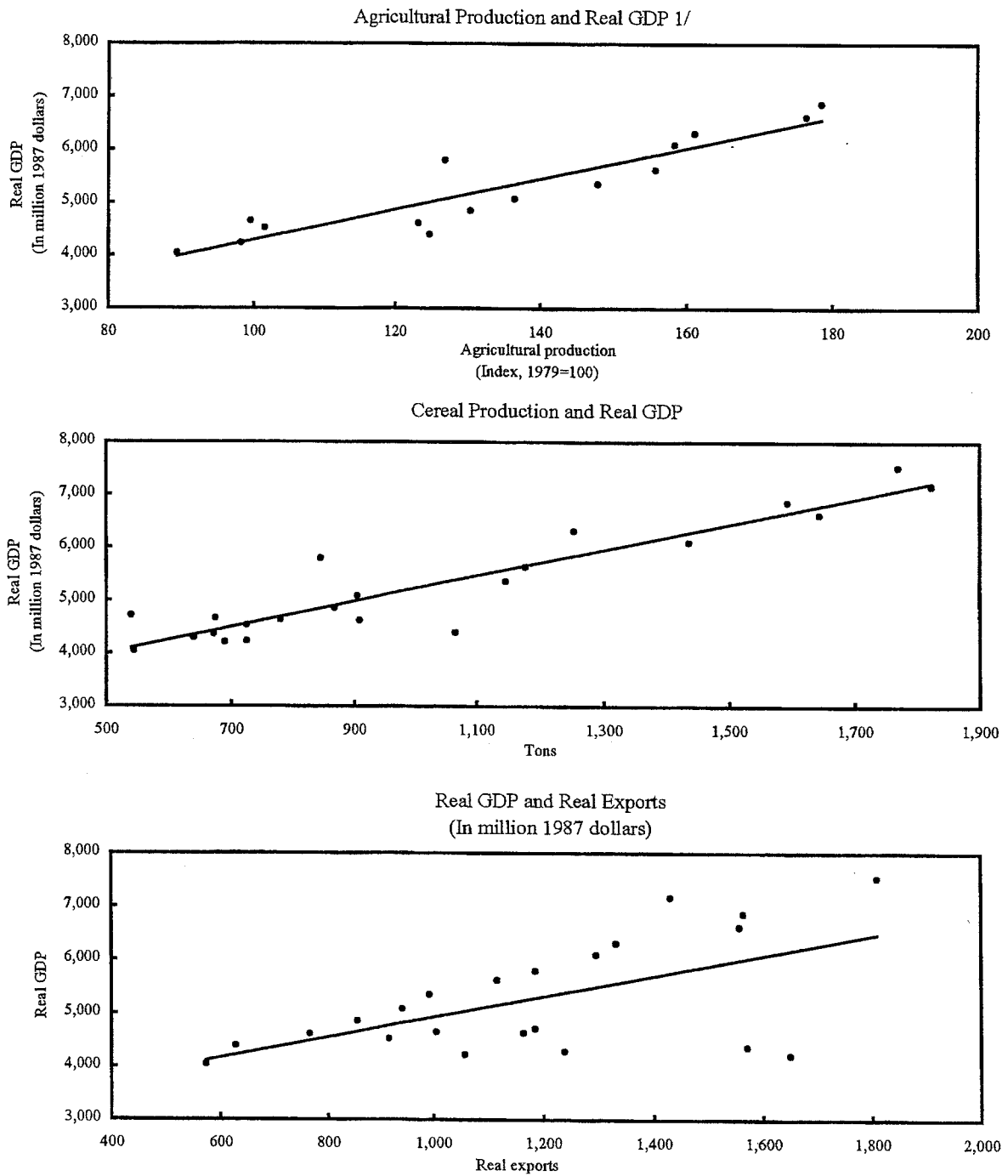
Figure 4. Ghana: Foreign Trade and the Current Account, 1975-98



27. The recent positive performance of the export volumes has been favorably reflected in per capita growth trends (Figure 5). Strong growth in the nontraditional sector indicate that small businesses have been able to diversify and successfully penetrate the European markets. Although part of the success in exporting to Europe could be due to the Lomé Convention, the recent success in diversifying exports suggests that the export sector might have the potential to become Ghana's "engine of growth."⁶

⁶ See Chapter II on nontraditional exports.

Figure 5. Ghana: Agricultural Sector and Real GDP, 1975-96

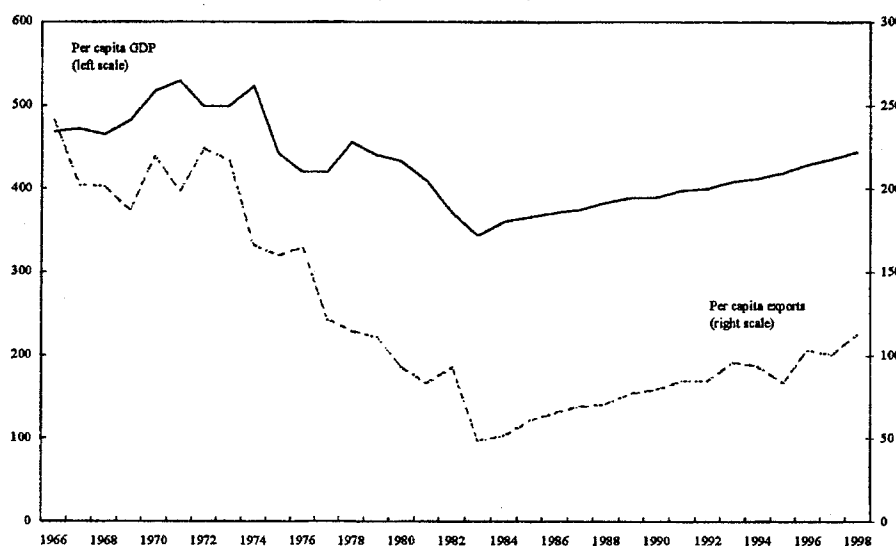


Sources: Ghanaian authorities; and staff calculations.

1/ Agricultural production was only available from 1980 to 1994.

28. **Imports.** Although the volume of imports has fluctuated widely over the past decades, broadly following macroeconomic trends, the import structure in terms of commodities has hardly changed. Machinery and transport equipment still represented 30 percent of total imports in 1997, about the same share that it held in the 1960s. Food and oil accounted for 10 percent and 17 percent of imports, respectively, in 1997. However, increases in imports of equipment are expected to spark productivity gains in the future.

Figure 6. Ghana: Per Capita GDP and Per Capita Exports, (1966-1998).
(In constant 1987 US\$)



D. An Analysis of Growth Patterns

29. Output growth in Ghana was severely impeded by the centralized economic management and inward-looking policies implemented from the mid-1960s to the early 1980s. The economic decline during this period is evident: in 1983 per capita income in constant cedis was about 40 percent lower than in 1970 (Figure 6).⁷ Per capita income in purchasing power parity (PPP) terms at constant 1985 dollars showed a decline of 30 percent in the period 1980–83 alone. As a result, the average Ghanaian in 1996 had about the same per capita income as his father had in 1971.

30. The slow growth in the manufacturing sector has meant that the economy remained predominantly rural, with the output in the agricultural sector strongly correlated with the

⁷ World Bank and IMF data; in constant 1975 cedis.

performance of real GDP and exports, even though industrial activity, in particular mining and extraction, has grown rapidly (Figure 5).⁸

31. Overall, Ghana can still be considered a “success story.” The sound macroeconomic management implemented since 1983, the privatization program, the gradual withdrawal of government from economic activity, market deregulation, and the restructuring and prioritization of the export sector have been the main factors behind a rising output trend, which has remained uninterrupted for the past 15 years.

32. To conclude, Ghana has succeeded in restoring macroeconomic stability, which in turn has enabled economic activity to recover from the crisis and assume an upward trend since the mid-1980s. Investment and productivity have been rising for more than a decade, allowing Ghana to regain lost output and setting the stage for continued growth in the future. The share of investment in GDP is now at the average level for the region, and export volumes have been steadily increasing, as export diversification makes the economy less exposed to terms of trade shocks. Domestic savings have been gradually increasing, in particular public savings, which has allowed for a reduction in the external balance and the maintenance of a sounder macroeconomic position. Overall, the Ghanaian economy should be able to generate sustained output growth rates for many years to come.

⁸ A long series for agricultural production was not available; thus this study used cereal production in metric tons as an index for agricultural production (Figure 5). The simple correlation between cereal production and agricultural production was about 70 percent in the period 1980-94.

Data Sources

The data used in this study rely on the estimates of sectoral production volumes as reported in the available issues of the *Quarterly Digest of Statistics* (GSS).⁹ GDP data were taken from IMF and World Bank databases and updated with current data received from authorities and IMF estimates. Investment data were taken both from IMF and World Bank databases and are based on estimates on construction and imported machinery performed by a local consultant for the GSS. Savings data were estimated from national accounts data.

The most recent published data of the commodity composition of trade, in the UN COMTRADE database, dates from 1992. Ghana's latest report to the IMF's *Direction of Trade Statistics* (DOTS) also refers to 1992; more recent data used in this study were taken from partner country data as reported in DOTS, and reports from the Ministry of Trade and Industry. A commodity composition of imports as reported in the EUROTRACE dataset compiled by the GSS in 1997 was made available to staff.

⁹ Issues available were 1971-72, 1981-82, 1985-92, 1997.

II. GHANA'S NONTRADITIONAL EXPORTS: PERFORMANCE AND PROSPECTS¹⁰

A. Introduction

33. Ghana is a small open economy that has traditionally relied on cocoa exports as the main source of foreign exchange. Until the 1970s, cocoa represented up to 70 percent of total exports of the country, with gold and timber accounting for most of the remainder. Dependence on export revenues from a limited number of commodities makes a country vulnerable to terms of trade shocks. The behavior of Ghana's exports illustrates the risks from lack of export diversification. After an upswing in its export prices in the late 1970s, Ghana faced declining cocoa prices in the 1980s, together with fluctuating gold and timber prices (Figure 7). As a result, growth rates, tax revenue and the current account tended to fluctuate from year-to-year, increasing uncertainty and disrupting macroeconomic adjustment.

34. The economic reforms implemented from 1983 set in motion a steady trend toward a gradual diversification of exports, in particular toward processed and semi-processed goods. The share of nontraditional products in total exports increased from 3 percent in 1986 to 19 percent in 1998. If sustained, this trend could progressively reduce Ghana's exposure to terms of trade shocks. In effect, prices of manufactured exports from Ghana have displayed much less volatility than those for its traditional exports, and have benefited from an upward price trend, which reflects an expanding world demand for these products (Figure 8).

35. Export growth has been sluggish in Africa and researchers have pointed to the low-income elasticity of demand and market saturation as stumbling blocks to achieving high-volume growth in traditional African export crops and minerals.¹¹ Over the period 1986-98, Ghana's traditional exports have, on average, grown at 7 percent per year, a relatively strong growth, but hardly sufficient to generate the high, sustainable rates of growth, which were envisaged in the Ghana Vision 2020 strategy. A gradual diversification away from the traditional export crops and minerals could contribute significantly to raise the growth rate of the economy. Nontraditional exports in Ghana have been growing at an yearly average of almost 27 percent during 1986-98. Although this performance is in part explained by the smallness of nontraditional exports, its sustained growth over more than a decade highlights their potential as a source of growth for the economy.

¹⁰ Prepared by Dev Kar.

¹¹ See, for example, Baban and Greene (1992).

Figure 7. Ghana: Commodity Prices of Traditional Exports, 1963-98

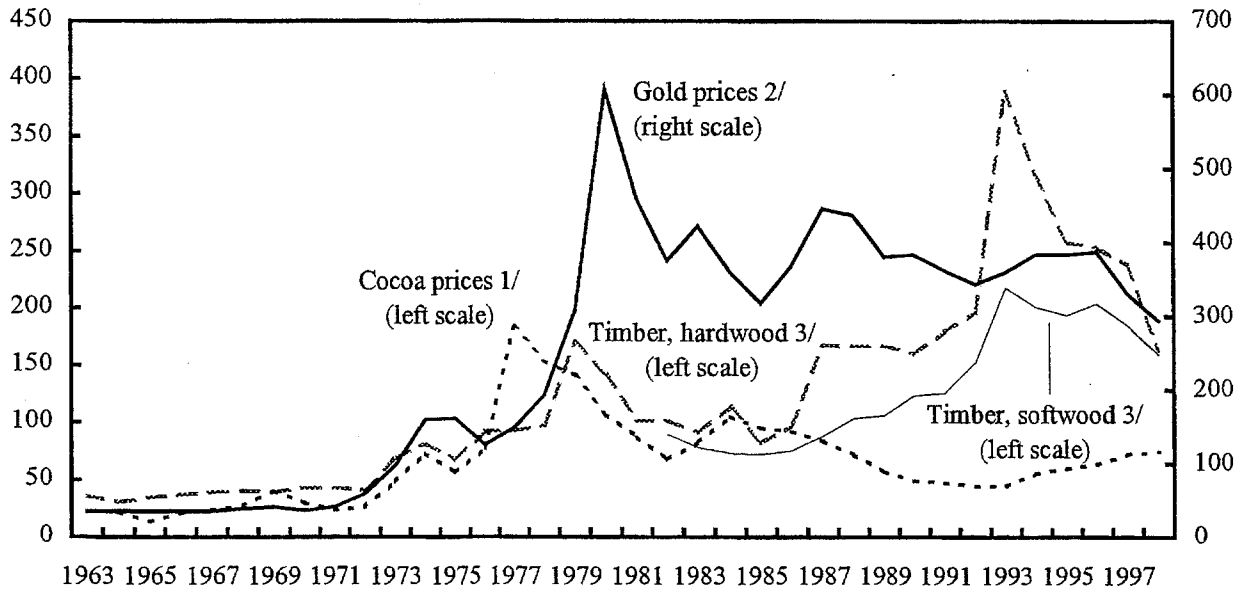
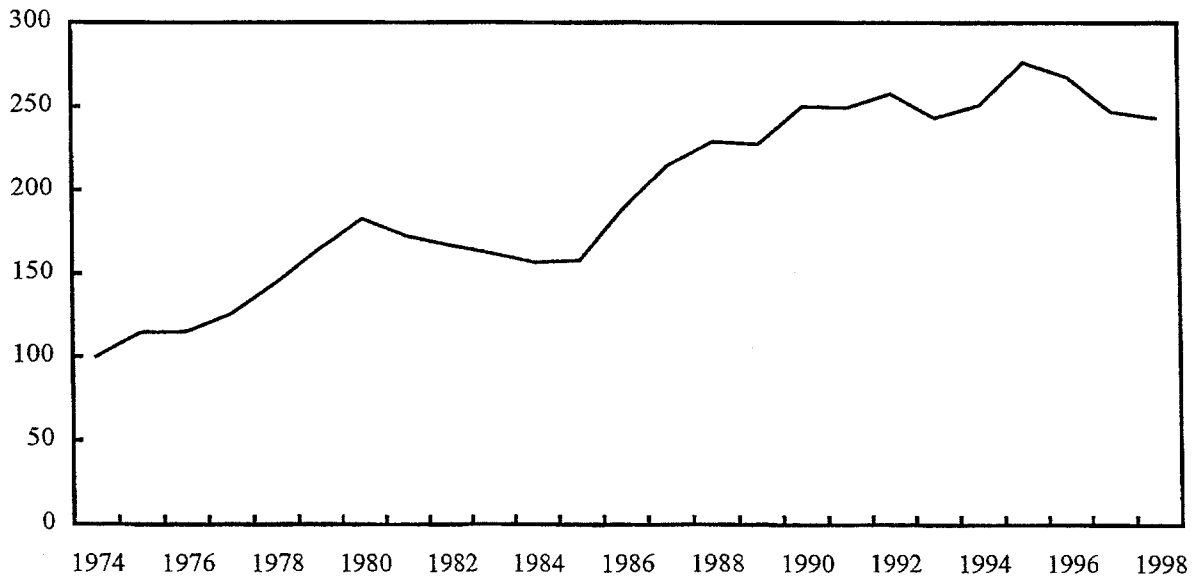


Figure 8. Ghana: Export Unit Value For Manufactures, 1974-98
(Index, 1974=100)



Sources: WEO; and Fund staff calculations.

1/ In U.S. dollars per ounce.

2/ In U.S. dollars cents per pound.

3/ In U.S. dollars per cubic meters.

36. This chapter discusses the performance of nontraditional exports since 1986 and their potential for continued expansion. At the outset, it should be noted that a nontraditional export is a country-specific concept. In August 1995, the Ghanaian parliament adopted the Export and Import Act No. 503. That act defines nontraditional exports as all exports other than cocoa beans, lumber and logs, unprocessed gold and other minerals, and electricity.¹² In practice, Ghana's nontraditional exports basically fall into three categories: agricultural products (mainly fruits, horticultural products, and fish), processed and semi-processed products (such as wood products, aluminum products, and canned foods) and handicrafts.

37. The plan of this chapter is as follows. Section B analyzes the overall performance of nontraditional exports both in terms of growth rates and product diversification. Section C describes the performance of the largest nontraditional exports, as well as possible obstacles to their future growth; it also reviews a number of smaller nontraditional exports, which may hold the key for higher export-led growth during the next decade. Section D examines government institutions and initiatives set up to foster the nontraditional export sector. The last section presents the main conclusions of the paper.

B. Performance of Nontraditional Exports, 1986-98

Overview

38. Provisional data show that by the end of 1998, export receipts from nontraditional exports stood at slightly over US\$400 million, or nearly 20 percent of total merchandise exports (Table 9 and Figure 9).¹³ Before 1990, the nascent nontraditional export sector contributed less than 5 percent of total exports and agricultural products tended to dominate the sector, representing 60-75 percent of total, while processed and semi-processed goods accounted for 25-38 percent. Exports of handicrafts were negligible, amounting to less than US\$1 million. As more industries came onstream since 1992, processed and semi-processed goods started to outstrip agricultural products in total nontraditional exports. In 1998, processed and semi-processed goods represented 79 percent of nontraditional exports, with agricultural products accounting for 19 percent and handicrafts 2 percent. Therefore, the growth of nontraditional exports has reflected to a great extent the recuperation of the industrial sector in Ghana as a result of economic reforms, privatization, and a more favorable environment for the private sector.

¹² Therefore, exports of aluminum, bauxite, manganese and diamonds are considered traditional exports.

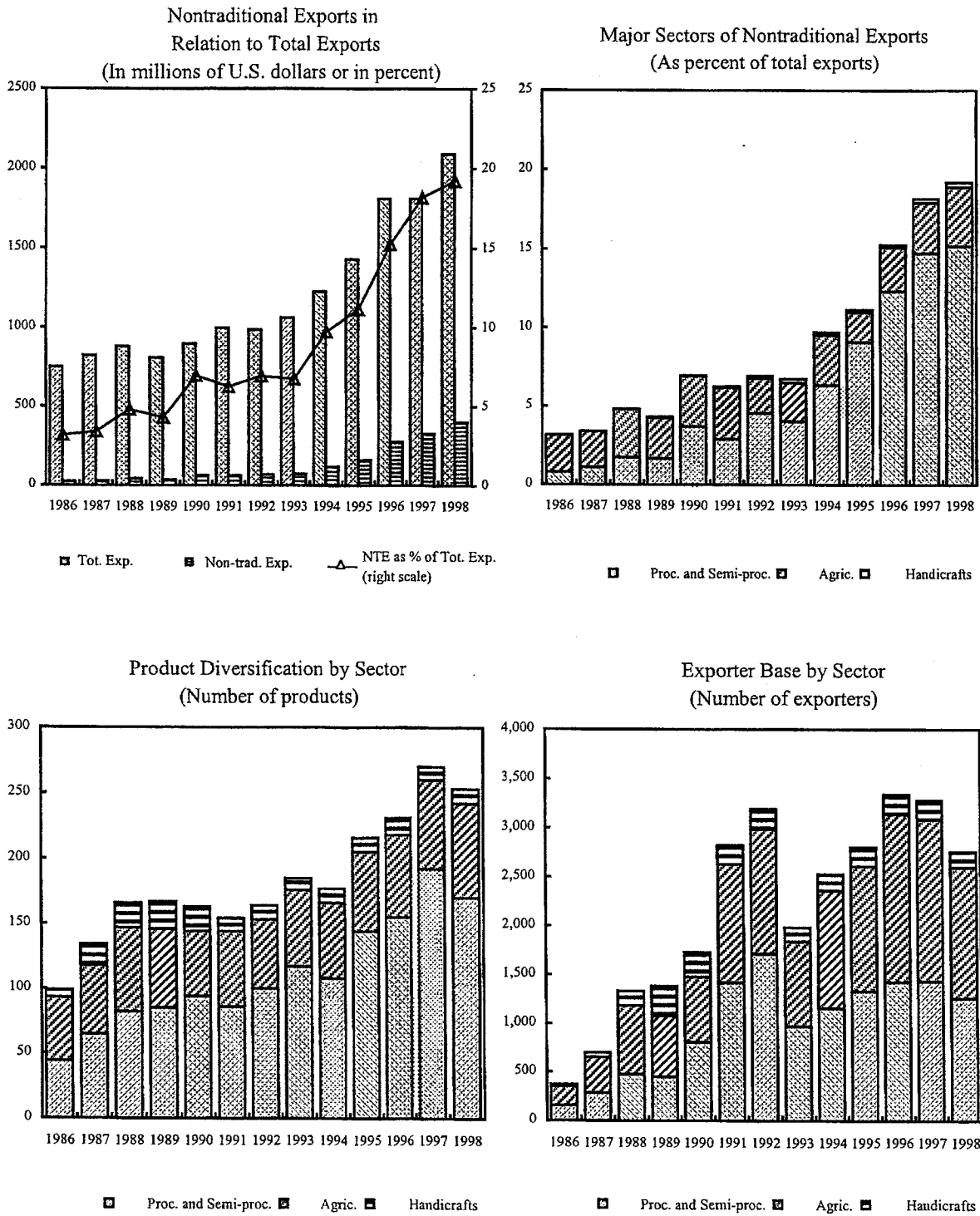
¹³ The data on nontraditional exports used in this chapter are compiled by the Ghana Export Promotion Council (GEPC). The data cover most, but not all, nontraditional exports from Ghana.

Table 9. Ghana: Major Nontraditional Exports, 1986-98
(In millions of U.S. dollars)

| | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Regression-based Rate of Growth | Growth Based on End Points |
|------------------------------------|-------|-------|-------|-------|-------|-------|-------|---------|---------|---------|---------|---------|---------|---------------------------------|----------------------------|
| Nontraditional exports (total) | 23.8 | 28.0 | 42.4 | 34.7 | 62.3 | 62.5 | 68.4 | 71.7 | 119.3 | 159.6 | 276.2 | 329.0 | 401.7 | 26.5 | 26.6 |
| Agriculture | 17.8 | 18.8 | 27.1 | 21.2 | 28.8 | 33.0 | 22.0 | 26.1 | 39.2 | 27.4 | 50.3 | 57.4 | 77.8 | 10.4 | 13.1 |
| Horticulture | 0.5 | 1.0 | 1.6 | 2.5 | 5.0 | 8.4 | 6.8 | 7.7 | 9.3 | 11.5 | 20.7 | 19.2 | 19.8 | 33.6 | 35.9 |
| Fish | 14.6 | 14.7 | 21.1 | 13.2 | 21.5 | 20.0 | 11.1 | 14.8 | 11.4 | 7.3 | 12.4 | 18.7 | 21.0 | -1.1 | 3.1 |
| Other | 2.7 | 3.1 | 4.4 | 5.4 | 2.3 | 4.6 | 4.1 | 3.6 | 18.5 | 8.6 | 17.2 | 19.5 | 37.0 | 21.7 | 24.4 |
| Of which | | | | | | | | | | | | | | | |
| Cocoa wastes | 2.1 | 2.4 | 2.9 | 2.2 | 1.8 | 1.8 | 0.7 | 0.2 | 0.2 | 1.1 | 1.0 | 2.2 | 3.6 | -5.4 | 4.6 |
| Processed and semi-processed | 5.9 | 9.1 | 15.2 | 13.3 | 33.0 | 28.6 | 44.9 | 43.0 | 77.8 | 130.2 | 223.0 | 266.9 | 317.5 | 39.5 | 39.4 |
| Wood | 1.5 | 2.1 | 3.3 | 3.8 | 5.5 | 5.5 | 15.5 | 18.8 | 30.1 | 37.5 | 66.9 | 71.0 | 84.6 | 43.2 | 39.9 |
| Aluminum products | 0.1 | 0.7 | 6.1 | 2.5 | 9.8 | 9.8 | 4.9 | 3.6 | 5.2 | 7.7 | 1.9 | 5.8 | 12.2 | 21.7 | 49.2 |
| Canned foods | 2.0 | 1.6 | 0.5 | 0.1 | 0.1 | 1.2 | 1.5 | 1.7 | 16.3 | 41.5 | 48.5 | 51.8 | 80.3 | 60.8 | 36.0 |
| Salt | 0.8 | 1.9 | 2.5 | 3.1 | 7.0 | 3.9 | 3.8 | 3.0 | 4.4 | 4.3 | 3.2 | 1.8 | 2.8 | 4.4 | 10.9 |
| Other | 1.5 | 2.7 | 2.8 | 3.8 | 10.6 | 8.2 | 19.2 | 15.9 | 21.8 | 39.2 | 102.5 | 136.5 | 137.6 | 47.0 | 45.7 |
| Handicrafts | 0.1 | 0.1 | 0.1 | 0.2 | 0.5 | 0.9 | 1.5 | 2.6 | 2.3 | 2.0 | 2.9 | 4.7 | 6.4 | 44.5 | 41.4 |
| Memorandum items: | | | | | | | | | | | | | | | |
| Total merchandise exports (f.o.b.) | 749.3 | 823.8 | 881.0 | 808.4 | 897.0 | 998.0 | 986.3 | 1,063.6 | 1,226.7 | 1,431.2 | 1,810.2 | 1,810.2 | 2,091.4 | 8.8 | 8.9 |
| Traditional exports | 725.5 | 795.8 | 838.7 | 773.7 | 834.7 | 935.5 | 917.9 | 991.9 | 1,107.4 | 1,271.6 | 1,534.0 | 1,481.2 | 1,689.7 | 7.2 | 7.3 |

Source: Ghana Export Promotion Council.

Figure 9. Ghana: Performance Indicators on Nontraditional Exports, 1986 - 98



Sources: Ghanaian authorities; and Fund staff estimates.

39. The overall growth in nontraditional exports over the period 1986-98 came mainly from the processed and semi-processed sub-sectors, which grew by nearly 40 percent per annum on average. Table 10 shows that the share of the processed goods in Ghana's total exports increased from less than 1 percent in 1986 to slightly over 15 percent in 1998—an impressive achievement by any measure. Aluminum and wood products, canned foods and other processed industries all registered significant increases in total export shares over this period. Although handicraft exports did not do as well, their share in total exports nevertheless increased.

40. Regarding the agricultural sector, the data show that horticultural exports were among the better performers growing by more than 33 percent on average per annum while fish exports have been on a downward trend owing to a variety of reasons including the lack of refrigeration facilities and difficulties in transportation to major markets.

Trading partners

41. The data on nontraditional exports by destination presented in Table 11 show that the European Union (EU) is the most important destination for Ghana's nontraditional exports, accounting for 68 percent of the total in 1998 followed by markets in the ECOWAS region (15 percent) (Figure 10).

42. Over 1986-1998, nontraditional exports to the EU have increased on average by 35.5 percent per year. Lower transportation costs and ease of delivery, particularly of perishable goods, such as horticulture and seafood, have tended to favor both EU and ECOWAS markets over far away markets in North America, Asia, and Latin America. Nevertheless, a decade ago, the EU accounted for only 29 percent of Ghana's nontraditional exports. What accounts for the change? Two aspects tend to dominate: (a) the favorable conditions for Ghanaian exports to the EU owing to the Lomé Convention;¹⁴ and (b) the expanding membership, and hence markets, of the EU itself.

43. Exports to the ECOWAS region (mainly the CFA zone) have also grown at nearly 30 percent on average during this period. However, the share of nontraditional exports going to the ECOWAS region has declined slightly from 17 percent in 1988 to 15 percent in 1998. This result is somewhat surprising, as in 1990 the ECOWAS Trade Liberalization Scheme was established to provide free movement of specified goods between member countries by phasing out existing tariffs over five years. The lack of expansion in Ghana's nontraditional exports to other ECOWAS countries points to the fact that the implementation of the scheme

¹⁴ Under the Lomé Convention, Ghana receives duty-free access to the EU market for industrial and agricultural exports not subject to the arrangements under the EU's Common Agricultural Policy. Several important or potentially significant processed and unprocessed food items such as cocoa products, fruits, and vegetables are eligible under this convention.

Table 10. Ghana: Performance Indicators on Major Nontraditional Exports, 1986-98

| Exports | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|--|------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| (Nontraditional exports as percent of total exports) | | | | | | | | | | | | | |
| Nontraditional exports | 3.2 | 3.4 | 4.8 | 4.3 | 6.9 | 6.3 | 6.9 | 6.7 | 9.7 | 11.2 | 15.3 | 18.2 | 19.2 |
| Agriculture | 2.4 | 2.3 | 3.1 | 2.6 | 3.2 | 3.3 | 2.2 | 2.5 | 3.2 | 1.9 | 2.8 | 3.2 | 3.7 |
| Horticulture | 0.1 | 0.1 | 0.2 | 0.3 | 0.6 | 0.8 | 0.7 | 0.7 | 0.8 | 0.8 | 1.1 | 1.1 | 0.9 |
| Fish | 1.9 | 1.8 | 2.4 | 1.6 | 2.4 | 2.0 | 1.1 | 1.4 | 0.9 | 0.5 | 0.7 | 1.0 | 1.0 |
| Other | 0.4 | 0.4 | 0.5 | 0.7 | 0.3 | 0.5 | 0.4 | 0.3 | 1.5 | 0.6 | 1.0 | 1.1 | 1.8 |
| Processed and semi-processed | 0.8 | 1.1 | 1.7 | 1.6 | 3.7 | 2.9 | 4.6 | 4.0 | 6.3 | 9.1 | 12.3 | 14.7 | 15.2 |
| Wood | 0.2 | 0.3 | 0.4 | 0.5 | 0.6 | 1.1 | 1.6 | 1.8 | 2.5 | 2.6 | 3.7 | 3.9 | 4.0 |
| Aluminum products | 0.0 | 0.1 | 0.7 | 0.3 | 1.1 | 1.0 | 0.5 | 0.3 | 0.4 | 0.5 | 0.1 | 0.3 | 0.6 |
| Canned foods | 0.3 | 0.2 | 0.1 | 0.0 | 0.0 | 0.1 | 0.2 | 0.2 | 1.3 | 2.9 | 2.7 | 2.9 | 3.8 |
| Salt | 0.1 | 0.2 | 0.3 | 0.4 | 0.8 | 0.4 | 0.4 | 0.3 | 0.4 | 0.3 | 0.2 | 0.1 | 0.1 |
| Other | 0.2 | 0.3 | 0.3 | 0.5 | 1.2 | 0.8 | 1.9 | 1.5 | 1.8 | 2.7 | 5.7 | 7.5 | 6.6 |
| Handicrafts | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.1 | 0.2 | 0.3 | 0.3 |
| (Product Diversification: Number of Products) | | | | | | | | | | | | | |
| Nontraditional exports (total) | 99 | 134 | 166 | 167 | 163 | 154 | 164 | 185 | 177 | 216 | 231 | 270 | 253 |
| Agriculture | 49 | 53 | 65 | 61 | 50 | 58 | 53 | 59 | 58 | 61 | 63 | 68 | 72 |
| Horticulture | 11 | 11 | 25 | 21 | 18 | 24 | 22 | 26 | 25 | 25 | 26 | 31 | 32 |
| Fish | 14 | 12 | 15 | 17 | 10 | 11 | 10 | 11 | 11 | 11 | 9 | 12 | 11 |
| Other | 24 | 30 | 25 | 23 | 22 | 23 | 21 | 22 | 22 | 25 | 28 | 25 | 29 |
| Processed and semi-processed | 44 | 65 | 82 | 85 | 94 | 86 | 100 | 117 | 108 | 144 | 155 | 192 | 170 |
| Wood | 8 | 7 | 7 | 9 | 12 | 6 | 10 | 8 | 8 | 10 | 12 | 12 | 10 |
| Aluminum products | 6 | 6 | 4 | 3 | 5 | 3 | 3 | 3 | 3 | 6 | 5 | 6 | 5 |
| Canned foods | 7 | 7 | 7 | 8 | 8 | 7 | 12 | 15 | 13 | 16 | 16 | 18 | 20 |
| Salt | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Other | 22 | 44 | 63 | 64 | 68 | 69 | 74 | 90 | 83 | 111 | 121 | 155 | 134 |
| Handicrafts | 6 | 16 | 19 | 21 | 19 | 10 | 11 | 9 | 11 | 11 | 13 | 10 | 11 |
| (Export Base: Number of Exporters) | | | | | | | | | | | | | |
| Nontraditional exports (total) | 373 | 696 | 1,331 | 1,381 | 1,729 | 2,822 | 3,188 | 1,980 | 2,529 | 2,802 | 3,339 | 3,278 | 2,760 |
| Agriculture | 197 | 367 | 708 | 627 | 668 | 1,214 | 1,270 | 869 | 1,206 | 1,280 | 1,714 | 1,654 | 1,344 |
| Horticulture | 109 | 118 | 268 | 157 | 203 | 528 | 572 | 387 | 589 | 708 | 1,008 | 1,053 | 886 |
| Fish | 47 | 94 | 168 | 149 | 156 | 309 | 367 | 214 | 278 | 266 | 328 | 308 | 132 |
| Other | 41 | 155 | 272 | 321 | 309 | 377 | 331 | 268 | 339 | 306 | 378 | 293 | 326 |
| Processed and semi-processed | 152 | 284 | 473 | 448 | 804 | 1,415 | 1,711 | 967 | 1,154 | 1,330 | 1,424 | 1,430 | 1,256 |
| Wood | 19 | 18 | 38 | 42 | 56 | 66 | 122 | 138 | 214 | 258 | 201 | 212 | 208 |
| Aluminum products | 6 | 5 | 7 | 8 | 17 | 27 | 24 | 14 | 14 | 18 | 23 | 35 | 39 |
| Canned foods | 36 | 35 | 14 | 19 | 22 | 50 | 70 | 57 | 94 | 93 | 108 | 99 | 85 |
| Salt | 32 | 117 | 169 | 151 | 152 | 252 | 207 | 153 | 129 | 116 | 84 | 61 | 57 |
| Other | 59 | 109 | 245 | 228 | 557 | 1,020 | 1,288 | 608 | 703 | 845 | 1,008 | 1,023 | 867 |
| Handicrafts | 24 | 45 | 150 | 306 | 257 | 193 | 207 | 144 | 169 | 192 | 201 | 194 | 160 |

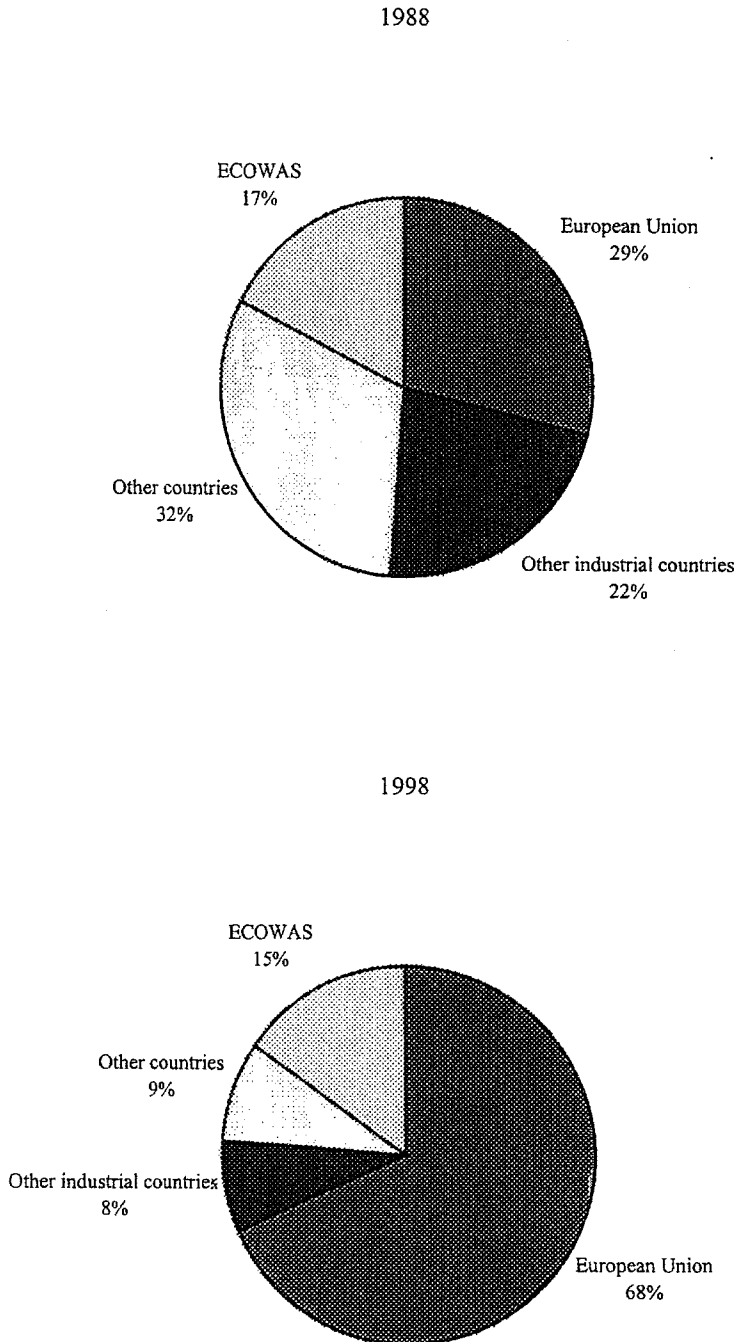
Source: Ghana Export Promotion Council.

Table 11. Ghana: Destination of Nontraditional Exports, 1986-98 1/
(In millions of U.S. dollars)

| Destination | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Regression- based Rate of Growth | Growth Based on End Points |
|----------------------------|------|------|------|------|------|------|------|------|-------|-------|-------|-------|-------|--|----------------------------------|
| European Union | 7.4 | 11.2 | 12.4 | 16.9 | 23.0 | 30.1 | 33.7 | 37.9 | 58.7 | 99.7 | 197.1 | 233.9 | 273.6 | 35.5 | 35.1 |
| United Kingdom | 1.7 | 3.0 | 5.0 | 5.8 | 7.1 | 7.8 | 6.9 | 8.3 | 20.3 | 28.0 | 48.2 | 56.3 | 64.5 | 33.4 | 35.4 |
| Other industrial countries | 13.8 | 12.3 | 9.3 | 8.4 | 4.4 | 8.3 | 8.0 | 11.8 | 11.5 | 9.5 | 18.5 | 35.1 | 31.6 | 9.0 | 7.1 |
| United States | 13.8 | 11.9 | 8.7 | 7.2 | 2.8 | 4.9 | 4.2 | 7.3 | 5.0 | 4.8 | 8.4 | 18.4 | 20.6 | 2.7 | 3.4 |
| ECOWAS | 1.6 | 3.7 | 7.4 | 5.2 | 13.3 | 13.0 | 19.3 | 14.6 | 18.9 | 27.1 | 40.6 | 37.4 | 61.6 | 28.8 | 35.6 |
| CFA Zone and other | 1.1 | 2.9 | 6.3 | 4.3 | 12.1 | 11.9 | 13.7 | 8.5 | 13.6 | 21.0 | 36.9 | 33.9 | 55.4 | 29.8 | 38.6 |
| Nigeria | 0.5 | 0.8 | 1.1 | 0.9 | 1.2 | 1.1 | 5.6 | 6.1 | 5.3 | 6.1 | 3.7 | 3.5 | 6.2 | 23.1 | 23.3 |
| Other Africa | 0.4 | 0.1 | 0.3 | 0.2 | 0.4 | 0.8 | 0.7 | 1.0 | 9.6 | 14.0 | 8.6 | 4.5 | 5.5 | 44.9 | 24.4 |
| Other countries | 0.6 | 0.7 | 13.0 | 4.0 | 21.2 | 10.3 | 6.7 | 6.4 | 20.6 | 9.3 | 11.4 | 18.1 | 29.4 | 25.3 | 38.3 |
| Total exports | 23.8 | 28.0 | 42.4 | 34.7 | 62.3 | 62.5 | 68.4 | 71.7 | 119.3 | 159.6 | 276.2 | 329.0 | 401.7 | 26.5 | 26.6 |

Source: Ghana Export Promotion Council.

Figure 10. Ghana: Destination of Nontraditional Exports



Source: Ghana Export Promotion Council.

has been timid. Exports to the CFA zone grew more rapidly than those to Nigeria, but may slow down in the future as the CFA countries become increasingly integrated through the removal of customs duties within the West African Economic and Monetary Union.

45. Exports to the United States have stagnated as Ghanaian exporters still lack the production capacity to meet the demand for large orders typically placed by U.S. importers.

Product diversification

46. The strong growth of nontraditional exports is to a considerable extent due to product diversification (Table 10). In 1986, the fledgling nontraditional export sector comprised just 100 products split almost equally between agricultural and nonagricultural (mainly processed and semi-processed goods) commodities. Over 1986-98, available data show that there has been a significant diversification of nontraditional exports led by the processed and semi-processed industries. The nontraditional export sector now exports more than 250 different products mainly to the EU, ECOWAS, and North America. Product diversification in exports has mostly taken place in other processed industries (that is, processing industries other than canned foods, wood products, aluminum, or salt), in which the number of products exported increased from 22 in 1986 to 134 in 1998. There was also significant product diversification in horticultural exports during this period (from 11 products in 1986 to 32 in 1998).

47. Along with the diversification of products, there has also been an expansion in the number of exporters. In 1986, there were less than 400 nontraditional exporters, but their number grew rapidly to 3,188 in 1992. The increase in inflation and uncertainty in the wake of the 1992 elections reduced the number of exporters and slowed down considerably the growth rate of nontraditional exports in 1993. Since then, the number of nontraditional exporters has recovered led by an increase in the number of agricultural exporters. But in 1998, even as nontraditional exports have continued to grow significantly in value terms, there was a decline in the number of exporters in both agricultural and nonagricultural sectors. Data for the first quarter of 1999 show that compared to the same period last year, total exports of nontraditional products have declined by 1.7 percent, as the slight growth in export receipts from processed goods was not sufficient to offset a decline of 11.3 percent in receipts from agricultural products. The real effective exchange rate, which continues to appreciate from its low level in 1994, is likely to have contributed to this development.

C. Main Nontraditional Exports

48. Ghana's main nontraditional exports in terms of export value have been processed and semi-processed goods, which in 1998 accounted for almost 80 percent of total nontraditional exports. In particular, four products, canned tuna, palm oil, processed cocoa products, and wood products (including furniture) accounted for 63 percent of total nontraditional exports. This section discusses the prospects of these four products and identifies a list of 10 other products that have a good potential for vigorous export growth in the near future.

Canned tuna

49. Ghana started exporting canned tuna in 1990/91. Until 1993, export receipts from canned tuna did not exceed about US\$1.0 million. In 1994, the Pioneer Food Company invested heavily in its canning facilities and led the way to the expansion of exports of canned tuna. The Ghana Agro-Food Company, which was a state-owned enterprise, was sold to the Swiss company IBN in 1994 and has since doubled its production of canned tuna and increased its total work force by more than three times to 1,600 employees. As a result of these initiatives, exports of canned tuna jumped more than sevenfold in 1994 to US\$7.7 million and have been growing strongly ever since. By the end of 1998, exports of canned tuna had reached US\$77.3 million, or nearly 20 percent of total nontraditional exports.

50. The success of canned tuna exports is an example of how foreign investment can help introduce marketing skills and investment, allowing a new export to be launched. Exporters of canned tuna, particularly those involved in exports to the United States and the European Union, tend to be international firms such as StarKist. These companies have transferred the marketing know-how as well as their experience in the handling, processing, and packaging of tuna to meet the high quality standards required in their export markets. Today, Ghana has acquired the expertise to produce and market canned tuna and should be able to expand exports of this product for years to come, particularly since recent studies do not indicate that there are as yet environmental constraints on tuna fishing in Ghana.

Palm oil

51. In 1986, there were only four Ghanaian exporters of palm oil. Since then, the number of exporters of palm oil has increased steadily. In 1998, over a hundred palm oil exporters sold nearly US\$20 million to foreign buyers, or about 5 percent of total nontraditional exports. While exports of palm oil have performed quite well until now, the palm oil industry was developed as a substitute for imports of edible oil.¹⁵ Turning these companies around and making them dynamic exporters in highly competitive international markets can be challenging. In Ghana, this is being achieved in part through the privatization of palm oil plantations and processing firms, which provide a new outlook to the companies. The Ghana Oil Palm Development Company was divested in 1994. Unilever has recently bought the Twifo Plantation from government. Other companies awaiting privatization are the Benso Oil Palm Plantation and the National Oil Palm Company, which has 4,500 ha. of palm plantation close to Takoradi, Ghana's second port.

52. The major market for Ghanaian palm oil has been the countries in the CFA franc zone. However, demand from these markets could dry up if there is a loss of relative competitiveness because of regional trade developments (such as the WAEMU customs

¹⁵ Stryker and Shaw (1994).

union) or because of relative exchange rate movements. Also, agroecological conditions in West Africa are not as favorable for palm oil as in southeast Asia, which remains Africa's strongest competitor.

Processed cocoa products

53. The three most important processed cocoa products exported by Ghana are cocoa butter, cocoa liquor, and cocoa cake—in that order. The quality and flavor of Ghanaian cocoa have helped boost exports of processed cocoa, which grew nearly six times in value from US\$12.5 million (8 percent of total nontraditional exports) in 1995 to US\$73.0 million (18 percent of total nontraditional exports) in 1998. Exports of cocoa products benefited also from the know-how of the Walter Schroeder Company, of the German Hosta group, which bought a controlling share of two state-owned cocoa processing plants in 1992 and 1993. The government has retained a 40 percent share of this company, the West African Mills Company. Since taking over the enterprise, the new owners have invested over DM 30 million; production of cocoa butter has risen from 10,000 to 20,238 tons a year in 1998, and processing of cocoa beans from 10,000 to 53,351 tons per year. Another exporter of cocoa products is the Cocoa Processing Company, which in addition to cocoa butter, powder, and liquor, also produces confectionery. It has two plants in the port of Tema. The Cocoa Processing Company is a subsidiary of the Cocobod. Its cocoa processing operations have also expanded significantly from 18,000 tons in 1992 to 25,000 tons in 1995. The company has plans to build another 25,000 ton processing plant by 2001.

Wood products (including furniture)

54. Among the most promising nontraditional exports are three wood products: building materials, furniture and furniture parts. Although the wood processing industry has in general performed very well, accounting for 21 percent of nontraditional exports in 1998, its potential for continuous expansion needs to be examined carefully. The wood products industry has benefited from a ban on the exports of logs for environmental reasons. However, future expansion of the industry will depend on the implementation of adequate environmental policies that encourage reforestation. As a first step, user fees would need to be levied in order to recover some of the cost of reforestation. During the 1999–2001 period, the government will also periodically increase forest fees to reflect the stumpage value of the trees, with rates ranging for 5 percent to 20 percent of the f.o.b. export timber prices, depending on demand and inventory level of the species.¹⁶ Part of the problems looming over the wood processing industry in Ghana could be resolved by better technology. Owing to

¹⁶ Other environmental efforts being carried out by the government with a bearing on the production and exports of wood products are the Timber Resource Management Act of 1998 and its regulations, as well as a pilot scheme on community collaboration in resources management.

outdated equipment, the maximum yield of sawmills in Ghana is between 40–55 percent of unprocessed timber and the rest is wasted in sawdust. An improvement in productivity could go a long way in preventing the imposition of tighter limits on exports of wood products.

Other promising nontraditional exports

55. Table 12 provides a list of smaller nontraditional exports that nevertheless have a high potential for growth in the next decade. This list draws mostly on information provided by the Ghana Export Promotion Council and provides summary information on growth potential, export performance, comparative advantages, markets, competition, and weaknesses.

D. Government Policies in Support of Exports

56. The **Ghana Export Promotion Council (GEPC)**, established in 1969, is a government agency in charge of export promotion and development. Its activities are geared toward broadening Ghana's export base and as a result it has given considerable attention to nontraditional exports. The GEPC assists exporters by identifying products and foreign markets with export potential, in part through the use of Ghana's embassies abroad. It also provides advisory services to exporters including product development, costing and pricing. Finally, it facilitates trade by promoting participation in trade fairs, and by working with the government to streamline export procedures.

57. The Export Production Village is an example of a GEPC program to foster nontraditional exports. Under the program, small rural producers are organized in companies which interface directly with exporters. The GEPC assists with sponsorship, equity participation, sourcing of production inputs, and extension services. The coverage of the program includes agricultural products, mainly fruits, vegetables, spices, staples and tree crops; shrimp farming; handicraft goods such as batik, rattan furniture, straw baskets, jewelry, and wooden items; and manufactured items, such as salt, processed cashew nuts, and coconut fiber products. Another example of a GEPC program is the promotion of rattan furniture for export under a project funded by Norway. About two-thirds of GEPC funding comes from domestic funds and one-third from external financing provided by bilateral donors and multilateral agencies, like UNDP.

58. In July 1993, the World Bank committed SDR 29.6 million in IDA funds (equivalent to US\$41 million) for the **Private Enterprise and Export Development (PEED)** project to promote nontraditional exports by refinancing and guaranteeing exports in that sector and assisting banks to extend credits to the nontraditional export sector. The PEED project, designed to foster the growth of nontraditional exports, had several components including (i) an export credit refinance and guarantee facility amounting to US\$34 million to assist exporters in obtaining short-term pre- and post-shipment finance from participating financial institutions; and (ii) a technical assistance component amounting to US\$7 million. The latter component was used to set up the Export Finance Office at the Bank of Ghana, which would implement the credit refinance and guarantee facility, train bankers and exporters in methods

Table 12. Selected Nontraditional Exports with High Potential for Growth

| Nontraditional Export Product | Export Performance | Markets to Explore | Comparative Advantage | Competition | Weaknesses | Growth potential |
|-------------------------------|---|---|---|---|---|--|
| 1. Basketwork | Increased 13 times in export receipts between 1993 and 1998 | United States and Japan Consolidate market in Germany. | 1. Skilled labor already available. 2. International marketing skills in place. | Asian suppliers that are long established. | Quality of products to be enhanced. | Growth expected with new projects boosting supply. Marketing strategies geared towards United States and Japan could boost demand. |
| 2. Cashew nuts | Very strong performance over 1994-98 (export receipts increased nearly four times). | 1. United States 2. Consolidate India (currently largest market) and Netherlands markets. Explore German and French markets. | 1. Increasing acreage's under cultivation. 2. Strong product development programs in existence. | Relatively well developed production and marketing systems in competitor countries (India, Brazil). | Lack of organized marketing infrastructure. No domestic processing. | Export performance up to 2005 projected at US\$5.5 million from US\$1.8 million in 1998. |
| 3. Coffee | 1. Very strong performance over 1995-98. 2. Export growth trend is on the upswing. | 1. United States (leading importer) 2. Germany, Italy, France, and Japan. | Product development programs in place. | Relatively developed production and marketing systems in Cote d'Ivoire. | Lack of organized marketing infrastructure. | Growth in production over 1995-98 to continue in coming years. |
| 4. Flowers | A new product whose performance is very encouraging. | Fast growing markets in United States, France, and the Netherlands. | 1. Favorable agro-climatic conditions. 2. Regular direct flights to major markets in Europe and United States. 3. Availability of trained manpower. | Other African producers. | 1. Lack of requisite storage and marketing infrastructure at farm and exit points. 2. Weak technical support services. | Cut flower production is growing and prospects for increased production very positive. |

Table 12. Selected Nontraditional Exports with High Potential for Growth (continued)

| Nontraditional Export Product | Export Performance | Markets to Explore | Comparative Advantage | Competition | Weaknesses | Growth potential |
|---|---|---|--|---|---|---|
| 5. Garments (including ethnic apparel and clothing) | Export receipts totaled US\$5.0 million in 1998--strong increases since 1992. | United States--large population of African Americans and those of African origin demand ethnic garments. | <ol style="list-style-type: none"> Existing production infrastructure. Special skills and trained manpower. Three large fabric manufacturing companies. Good experience in cutting and sewing. | Competition from Asian and African suppliers. | Lack of marketing infrastructures abroad. | Expanded production in existing plants can double exports to US\$10 million in two years. Additional production in Export Processing Zones would increase supplies substantially. |
| 6. Ginger | Growth in export receipts has been significant over 1994-98. | U.S. and Japan. Ghana exports mainly to United Kingdom and Canada. | Favorable climatic and agronomic factors for production. | Competition from Nigeria. Jamaica has a niche market. | Lack of organized marketing infrastructure. Lack of local expertise in product handling. Lack of processing facilities. | Positive trend in production and supply to continue in the medium term. |
| 7. Jewelry (of precious metals and metal clad with precious metal). | Not yet a major export product. Six companies completed test marketing in United States and Canada. | United States (leading importer of gold jewelry). Also, Europe, particularly United Kingdom. Regional market in Nigeria and Zimbabwe. | <ol style="list-style-type: none"> Abundant raw materials. Professionally trained jewelry workers. Substantive equipment in two major production companies. | Asian suppliers are established in major markets. | Lack of standards and quality control. | With completion of registration formalities with major companies in United States, jewelry exports are expected to reach over US\$2 million by end 2001. |
| 8. Sunflower | Not yet a major export product | Europe | <ol style="list-style-type: none"> Active association of producers. 5,000 producers High oil content as compared to other countries. High yields per ha. | Argentina, China. | Lack of marketing structures. | Excellent. Prices have been attractive. |
| 9. Table, kitchen and other household articles (of aluminum). | Export receipts have grown by more than three times between 1997-98. | Burkina Faso and Benin are Ghana's major export markets. Explore Cote d'Ivoire. | <ol style="list-style-type: none"> Proximity of markets. Very little sub-regional competition. Availability of skilled manpower. | Imports from Europe. | Europe's better marketing infrastructure and technological skills. | High growth potential in medium term. |

Table 12. Selected Nontraditional Exports with High Potential for Growth (concluded)

| Nontraditional Export Product | Export Performance | Markets to Explore | Comparative Advantage | Competition | Weaknesses | Growth potential |
|-------------------------------|---|---|--|--|---|------------------|
| 10. Yam (fresh or dried). | Very good export performance with stable growth over 1995-98. | United Kingdom is Ghana's leading export market. Explore US market. | <ol style="list-style-type: none"> 1. Availability of production manpower. 2. Availability of production systems. 3. Possibility of large-scale production. | Existence of market barriers (in terms of quality requirements). | <p>Dependency on rainfall patterns.</p> <p>Lack of storage facilities.</p> <p>Small-holder farming.</p> | Excellent. |

and practices of export finance, and develop and implement an international payments settlements system.

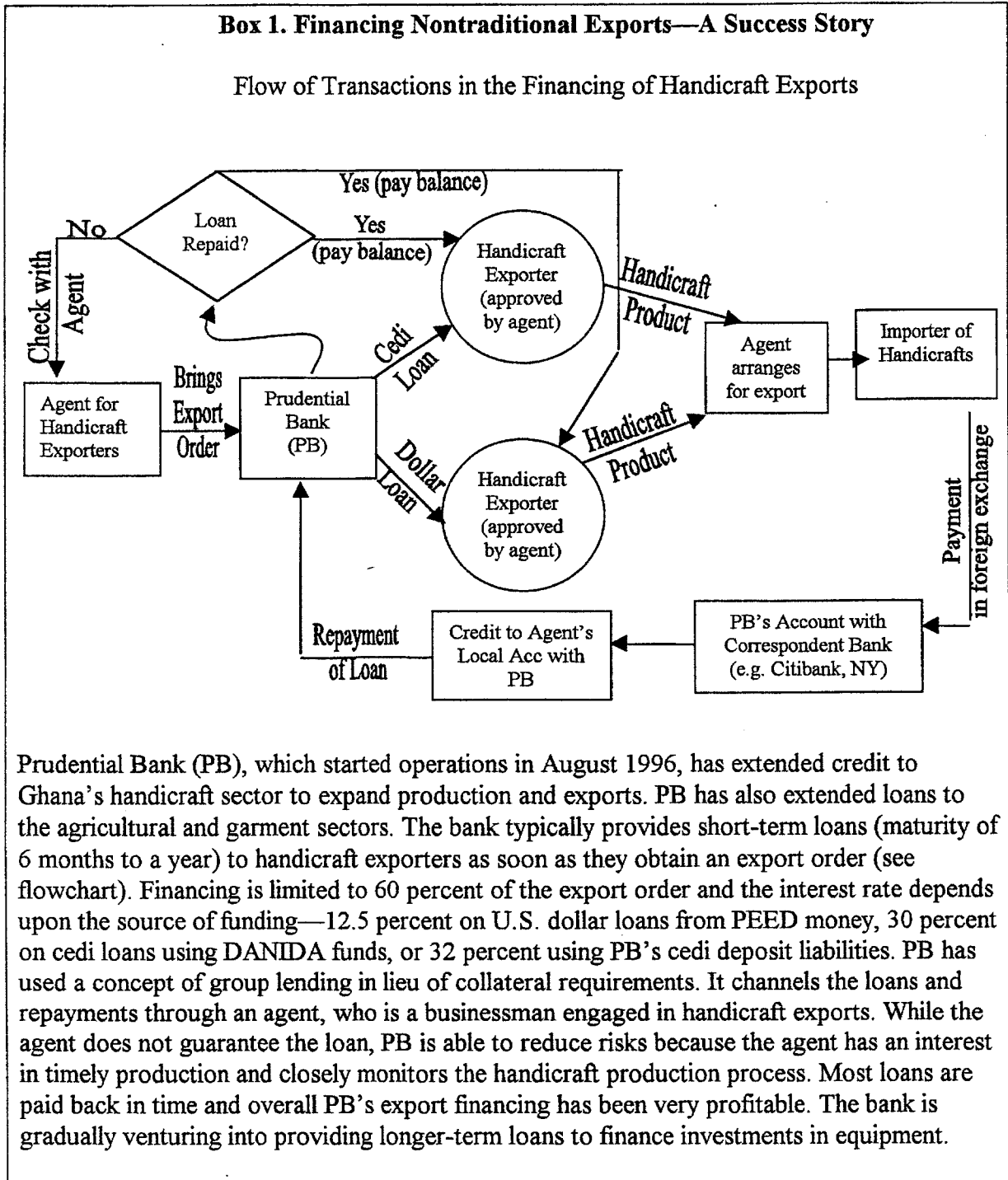
59. The impact of the PEED project on nontraditional exports was modest. The line of credit under the PEED project is estimated to have helped only about 11 percent of incremental exports to materialize, and the export financing scheme was plagued by high default rates and the continued erosion of their financial resources. In 1997, from US\$10 million of debt service due, 40 percent was yet to be recovered from about 30 defaulters (or 65 percent of borrowers). At that time, only three banks continued to be eligible to participate under the PEED scheme. The utilization rate of the credit facility remained low despite modifications to the facility because banks were unwilling to take risks on smaller and new nontraditional exporters, market interest rates were high, and exporters required medium-term funds, which were in short supply. Finally, the objectives of some technical assistance components designed to provide business assistance to exporters and private financial institutions were only partially realized in the absence of post-shipment guarantees. Recently, however, a small bank has become active in providing export credit to handicraft producers and exporters and has done so successfully (Box 1).

60. The **Export Finance Company (EFC)** was established in August 1990 with the support of the Bank of Ghana in order to grant loans to exporters of nontraditional goods, to provide export finance guarantees, and to support all ancillary functions for expanding nontraditional exports. Four public sector institutions (including the GEPC and the SSNIT) and four private insurance companies each hold 12.5 percent of EFC's shares. From the start, EFC experienced serious problems in its operations as shareholders were only able to raise 9 percent of the total proposed capital. As a result, EFC was compelled to tap the money markets and float export bills with government backing. EFC was able to obtain resources at 32 percent on average, and adding its own 2 percent margin, could only offer financing to nontraditional exporters at 34 percent. Another problem faced by EFC was that its staff at that time had no experience in running an export credit agency or in financing exports. Although EFC required high collateral such as treasury bills, bonds, and landed property, it took a long time to collect when 80-90 percent of its loans went bad in the period 1991-93 and a temporary freeze on EFC's lending became necessary. A turnaround in EFC's operations started in 1994 with its review of lending guidelines to improve prudential management and infusion of more skilled staff to assess risks, and the recovery of new loans increased to about 95 percent. However, the institution remains in a delicate financial situation given its narrow capital and resource base.

61. As quality takes the center stage in international trade, advanced concepts such as ecolabeling, organic products, and environment-friendly production processes increasingly influence the marketability of nontraditional exports. The Ghana Standards Board (GSB) has taken the lead in providing technical assistance in such areas as quality management and export packaging to assist Ghanaian enterprises and exporters to improve their ability to

Box 1. Financing Nontraditional Exports—A Success Story

Flow of Transactions in the Financing of Handicraft Exports



Prudential Bank (PB), which started operations in August 1996, has extended credit to Ghana's handicraft sector to expand production and exports. PB has also extended loans to the agricultural and garment sectors. The bank typically provides short-term loans (maturity of 6 months to a year) to handicraft exporters as soon as they obtain an export order (see flowchart). Financing is limited to 60 percent of the export order and the interest rate depends upon the source of funding—12.5 percent on U.S. dollar loans from PEED money, 30 percent on cedi loans using DANIDA funds, or 32 percent using PB's cedi deposit liabilities. PB has used a concept of group lending in lieu of collateral requirements. It channels the loans and repayments through an agent, who is a businessman engaged in handicraft exports. While the agent does not guarantee the loan, PB is able to reduce risks because the agent has an interest in timely production and closely monitors the handicraft production process. Most loans are paid back in time and overall PB's export financing has been very profitable. The bank is gradually venturing into providing longer-term loans to finance investments in equipment.

compete in international markets. GSB has also been developing a database and a library containing information to respond to exporters' enquiries on the technical and legal specifications required to market specific nontraditional exports.

62. The **Ghana Trade and Investment Gateway Project**, a US\$50.5 million World Bank-financed initiative, aims at attracting a critical mass of export-oriented investors to Ghana to accelerate export-led growth, while making Ghana a gateway to the West African market of 250 million people. A crucial element of the project is the creation of a privately-developed and managed Export Processing Zone (EPZ). An enabling legal and regulatory environment has been put in place through the adoption of the Investment Promotion Center Act of 1994 and the Free Zone Act of 1995.¹⁷ Industrial sites in three favorable locations close to ports and/or transportation facilities have been secured.¹⁸

63. To assess the viability of the project the government commissioned a survey of foreign investors to compare Ghana's investment climate to those in Dubai and Mauritius (considered best practices) and Togo and Kenya (potential competitors). The main finding of the survey is that Ghana has favorable investment and export incentives. Its labor regime is satisfactory and there is an adequately skilled or trainable labor force. The transportation system is at par with comparators and costs of sea and air freight are competitive. However, Ghana's basic infrastructure is slightly below that of comparators.

64. A number of trade facilitation activities have been identified and are being gradually put into place under the World Bank project. Key elements include: design and development of the Tema EPZ; implementation of a work program to achieve ISO 9000 certification of Ghana's customs and port clearance processes; private management of ports and terminals under the Ghana Ports and Harbor Authority; reform of the Ghana Civil Aviation Authority and implementation of a "liberalized skies policy"; support to the Ghana Investment Promotion Center and the Ghana Free Zones Board; and steps to promote trade facilitation by the Ghana Immigration Services.

65. In 1993, the Government of Ghana launched the **Ghana Trade and Investment Program (TIP)** with a US\$80 million grant from the USAID in order to expand exports of nontraditional products and diversify the country's export base. In 1996, the USAID funded a study to assess the income and employment impact of the TIP. The study, carried out by the Sigma One Corporation, was based on a survey of nontraditional exporters with an overall firm response rate of 75 percent. The main conclusion of the study was that the TIP had resulted in a sizeable increase in direct employment and annual wages for workers in the

¹⁷ A number of enterprises have already received authorization to operate in export zones, and applications for several others are being processed.

¹⁸ The sites are in Tema, Takoradi, and Kumasi.

nontraditional export sector that was substantially higher than the daily minimum wage. Direct full-time equivalent employment in nontraditional export firms increased from 12,000 jobs in 1993 to almost 27,000 jobs in 1995. Finally, the provision of technical assistance to the nontraditional export sector with simultaneous reform of the regulatory environment encouraged exporters to diversify their product line and increase their export capacity.

66. The TIP has now been replaced by the **Trade and Investment Reform Program (TRIP)**, which aims at expanding the production base of the economy and to build up on competitive strengths to place the country in a position to benefit from opportunities for export in a global environment of increasingly free trade. One study being undertaken under the TRIP is a comprehensive analysis of the tariff structure with a view to enhancing the competitiveness of local industry, and removing distortions that impede exports of goods in which Ghana has a comparative advantage.

67. USAID has also financed the **Federation of Associations of Ghanaian Exporters (FAGE)**, which is an umbrella organization set up in 1992 to represent the various export organizations in the country. FAGE provides support to nontraditional exporters through technical assistance. For example, it recently provided, in collaboration with the Ghana Standards Board, technical assistance in packaging and handling to ensure that Ghana's nontraditional exporters are able to meet the standards of the EU.

68. A new law establishing the **Export Development and Investment Fund** is expected to be presented to parliament in 1999.¹⁹ The Fund will operate as a guarantee scheme to provide long-term investment finance for exporters who may need to retool in order to increase their production and exports.

E. Conclusion

69. Ghana's nontraditional exports have grown rapidly albeit from a small base. They are becoming increasingly diversified, covering over 250 different products and amounting to more than US\$400 million. Moreover, today most nontraditional exports are processed and semi-processed goods, which benefit from a growing world demand and more stable international prices. This chapter has identified a number of products that could contribute to maintaining the high growth rate that nontraditional exports have experienced since 1986. However, it has also noted a number of areas in which the government will need to cooperate with the private sector to maintain this momentum. These areas include:

- *Maintaining a stable macroeconomic environment and adequate exchange rate policies.*
- *Encouraging foreign investment in the economy.*

¹⁹ ISSER (1999), p. 140.

- *Accelerating the divestiture program.*
- *Ensuring a competitive environment for exporters located in Ghana.*
- *Improving basic infrastructure connected to exports.*
- *Implementing trade facilitation activities, particularly those identified within the World Bank Gateway project.*
- *Providing opportunities for capacity building in international marketing, packaging, and handling to ensure that Ghanaian products meet international standards.*
- *Encouraging banks to develop creative financing facilities that cater to the needs of nontraditional exporters.*

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III. MEDIUM-TERM FISCAL SUSTAINABILITY ANALYSIS²⁰

A. Introduction

70. The need for a medium-term fiscal sustainability analysis is evident from the current threat to Ghana's economic performance posed by external shocks in 1999, which contributed to an excess in net domestic financing over projected levels and consequent increase in domestic debt. The medium-term fiscal model used to carry out this analysis is consistent with the macroeconomic framework and budget forecasting methodology underlying the ongoing ESAF-supported economic program. It is used to assess whether the fiscal position of the government remains sustainable after the external shock, and if not, whether planned adjustments in fiscal policy are able to restore domestic financing and debt to sustainable levels.

B. Stylized Model

71. Analysis of fiscal sustainability is based on projections of revenue, expenditure, and financing within a consistent macroeconomic framework. Given projections of real GDP growth, inflation, trade, and external financing, the macroeconomic model generates estimates of interest rates and exchange rates, as well as the fiscal position, including detailed projections of revenue and expenditure based on the tax structure and expenditure programs. Simulations can then be used to analyze the effects of different policies on fiscal sustainability. The following indicators of fiscal sustainability are examined: (a) the domestic revenue-to-GDP ratio; (b) the ratio of interest payments to revenue; (c) the overall deficit as a percent of GDP; (d) the domestic primary balance as a percent of GDP; (e) net domestic financing as a percent of GDP; and (f) the ratio of domestic debt to GDP. The stylized macroeconomic model underlying the fiscal sustainability analysis is comprised of the following components:

Revenue

72. Ghana's domestic revenue is composed of domestic tax and nontax revenues and trade taxes. Both domestic taxes and nontax revenues are predominantly a function of nominal GDP. Direct taxes, VAT on domestic goods, excise taxes, petroleum taxes, and nontax revenue are assumed to be proportional to GDP. VAT and tariff collections from imports are a function of imports and the exchange rate. Cocoa taxes depend on a number of factors, such as world and producer prices, which are exogenous to this stylized model, and the exchange rate. Therefore, the *domestic revenue-to-GDP ratio* can be expressed as:

²⁰ Prepared by Anthony Pellechio.

$$r = a + E \cdot (\tau \cdot m^* + c^*) \quad (1)$$

where a represents domestic taxes and nontax revenues, E is the exchange rate, τ represents the effective tariff, m^* is imports and c^* represents cocoa taxes.²¹ In the absence of tax changes, the revenue-to-GDP ratio tends to decline over time because the cocoa tax is expected to fall as a proportion of GDP over the medium term. Although imports are expected to grow broadly in line with GDP, the effective tariff is also expected to decline over time as a result of tariff reforms. The remaining source of revenue is *external grants*:

$$\text{External grants} = E \cdot g^* \quad (2)$$

where the amount of grants, g^* , is exogenous in terms foreign currency.

Expenditures

73. There are four types of expenditures: (a) domestic primary expenditure; (b) domestic interest payments; (c) foreign interest payments; and (d) foreign-financed capital expenditures. *Primary domestic expenditure*, s , is a function of nominal GDP. The main components of primary domestic expenditures do not vary proportionally with GDP over the medium term. For example, the nominal income elasticity of wage payments is less than unitary given the government's policy of reforming the public service to make it more efficient. Domestic capital expenditure is projected to rise as a percent of GDP to compensate, but not fully, for the decline in external project financing. Recurrent spending on goods and services rises slightly in 2006-07 as a consequence of higher domestic capital expenditure.

74. *Domestic and foreign interest payments* are given by:

$$\text{Domestic interest payments} = I \cdot d \quad (3)$$

$$\text{External interest payments} = E \cdot I^* \cdot d^* \quad (4)$$

where I and I^* are the domestic and external interest rates, respectively, and d and d^* , the stock of domestic and foreign debt, respectively. *Foreign-financed capital expenditures*, f , are assumed to be equal to total disbursements of external project grants and loans.

75. The *ratio of domestic interest payments to revenue* is given by:

$$\text{Domestic interest payments-to-revenue} = (I \cdot d) / [a + E (\tau \cdot m^* + c^*)] \quad (5)$$

²¹All lower case variables are expressed as a share of GDP. The asterisk represents values expressed in foreign currency and assumed exogenous. Imports in the baseline scenario are a function of GDP, but not in subsequent simulations.

Overall and primary domestic deficits

76. The *overall deficit*, b , is the difference between revenue and expenditure:

$$b = a + E(\tau \cdot m^* + c^* + g^*) - s - I \cdot d - E \cdot I^* \cdot d^* - f \quad (6)$$

77. The *primary domestic deficit*, z , is the difference between domestic revenue and primary domestic expenditure:

$$z = a + E \cdot (\tau \cdot m^* + c^*) - s \quad (7)$$

Domestic debt

78. The domestic debt stock can be derived from the government budget constraint, as the overall budget deficit has to be financed either externally or domestically. Therefore:

$$d_t = d_{t-1} + s + I \cdot d - a - E \cdot (\tau \cdot m^* + c^* + g^* + \Delta d^* - I^* \cdot d^*) \quad (8)$$

Nominal GDP, exchange rate, nominal domestic interest rate

79. *Nominal GDP*, Y , is obtained from exogenous projections of real GDP growth and inflation.

$$Y = P \cdot y \quad (9)$$

where P is the GDP deflator.

80. The *exchange rate* depreciation is assumed to adjust according to purchasing power parity:

$$g_E = g_p - g_p^* \quad (10)$$

where g_E is exchange depreciation, g_p is domestic inflation and g_p^* is foreign inflation.

81. The *nominal domestic interest rate* is given by:

$$I = g_p + K \quad (11)$$

where K is the real interest rate which is assumed to be related to risks associated with uncertainty about the sustainability of the fiscal position and, more generally, of macroeconomic policies. Therefore, any change in projected domestic inflation affects nominal GDP, the exchange rate, and nominal interest.

C. The Original Medium-Term Outlook

82. The government's original program for 1999–2001 was designed to support real GDP growth of 6 percent and, through adherence to prudent financial policies, reduce inflation to no more than 5 percent over 1999–2001. The program moved the overall fiscal deficit toward balance in line with the *Ghana—Vision 2020* strategy, and domestic primary surpluses to at least 3.5 percent of GDP by 2001 so as to reduce domestic debt. Net domestic financing of the budget was projected to fall to 1.3 percent of GDP in 2001 and the stock of domestic debt to begin declining relative to GDP by 2001. To achieve these objectives, expenditure growth would be restrained, although expenditures in health and education were to be protected.

83. Over the medium-term, the government plans to reform its tax system, shifting from reliance on trade taxes toward taxation of domestic consumption, thereby raising revenue more efficiently to support expenditure programs while improving equity. The tariff policy reforms are expected to start next year and continue through the medium term. Import tariff reform is guided by regional integration and the overall objective of reducing tariffs to improve the efficiency and competitiveness of Ghana's productive activities. Specifically, the government plans to reduce the top import tariff rate from 25 percent to 20 percent by the beginning of 2000 and shift goods to lower rates over the medium term, thereby reducing the average tariff rate below 10 percent and the effective rate, τ , from 7.3 percent in 1999 to 6 percent in 2007. The government's original plan under its medium-term cocoa strategy included the gradual reduction of the cocoa export tax to 15 percent of the world f.o.b. price by the 2004/05 crop season. This was designed to raise the incentive to produce cocoa and improve incomes of producers who comprise a large segment of the rural population engaged in small-scale cocoa production.

84. To compensate for the revenue losses from trade tax reform and meet spending requirements, the VAT rate was to be raised by annual increments of $\frac{1}{2}$ percentage point over 2001–06, bringing the rate to 13 percent. To further improve efficiency, petroleum taxes would be increased. By 2007, tax revenue was projected to rise above 17 percent of GDP, the overall budget to be in surplus by 1 percent of GDP, net domestic financing negative, and the stock of domestic debt below 10 percent of GDP. The domestic debt stock was expected to decline by about one-half relative to GDP over the medium term, allowing real interest rates to decline and making the fiscal position significantly stronger than at the present time.

D. The Baseline Scenario

85. The delays and shortfalls in external assistance in 1999 and deterioration in the terms of trade by over 13 percent in 2000 substantially changed the medium-term outlook. Real GDP growth for 1999 is projected to be lower than originally projected, specifically 4.5 percent rather than 5.5 percent, owing to tighter financial policies and external factors. The decline in the price of cocoa is expected to have greater impact next year, with external financing gaps opening up in 2000 and 2001 that can only be partially closed with external assistance. To fully close these gaps, imports are expected to be lower than originally projected under the program, thereby slowing GDP growth. In particular, real GDP growth is projected to be 4 percent in 2000, 4.5 percent in 2001, and reach 6 percent only in 2003.

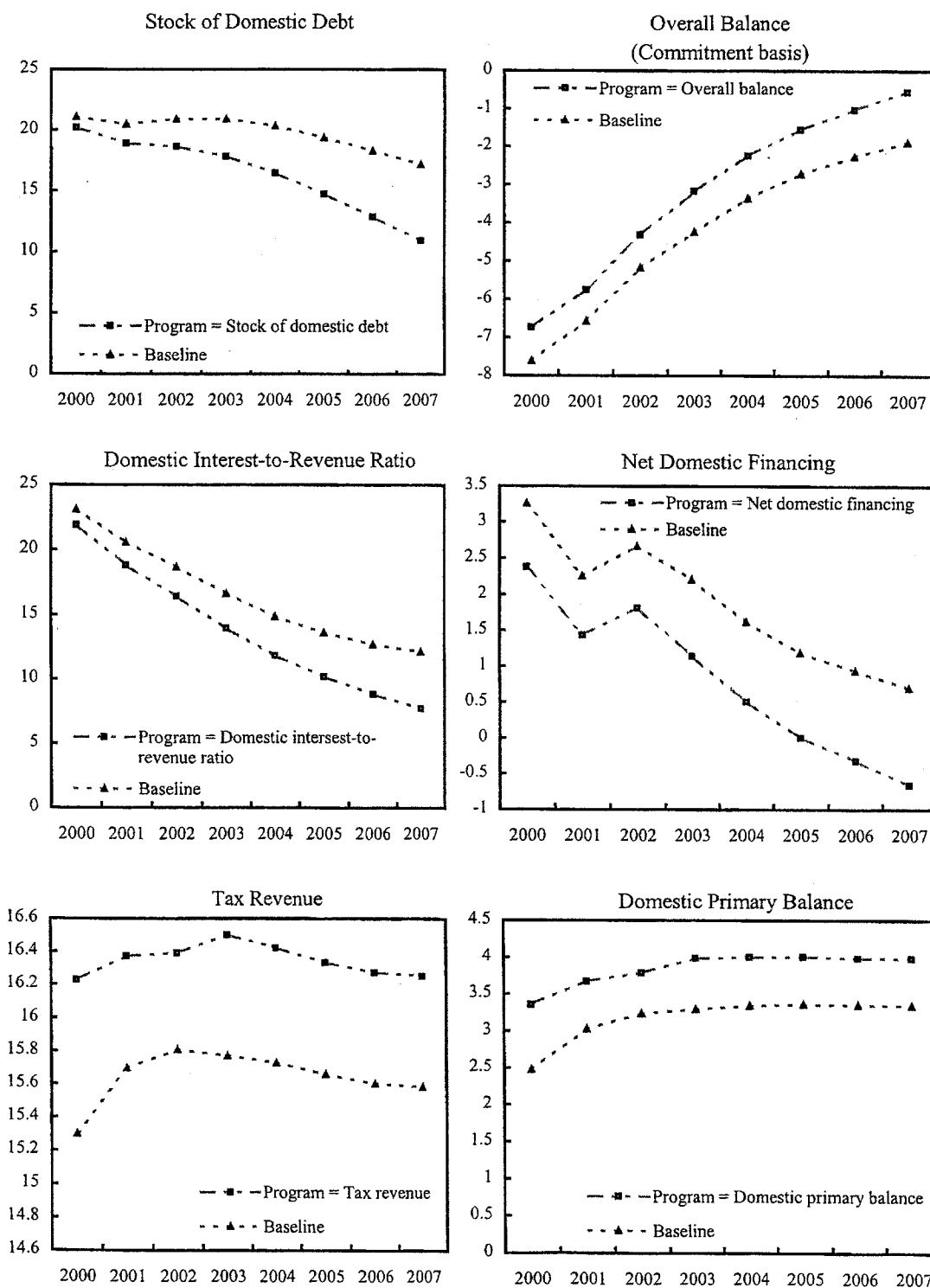
86. The baseline for examining fiscal sustainability is the medium-term projection of fiscal accounts based on the revised macroeconomic and external projections, and tax and expenditure policies in 1999, with, in particular, the VAT rate remaining at 10 percent.²² The ratio of direct taxes, indirect taxes (except VAT on imports), and nontax revenue to GDP remains constant through the medium term given unchanged domestic tax rates and a projected unitary elasticity of these revenue sources with respect to GDP. The VAT on imports and trade taxes are based on the medium-term projections of imports and cocoa exports and the effective tariff rates implied by tariff reform and the medium-term cocoa strategy.

87. Given the tax burden, expenditures will need to be curtailed over the medium term. Capital expenditures decline over the medium term as external project assistance is projected to decrease and the role of the private sector in the economy is expanded. Domestic capital expenditure is expected to increase only slightly. Transfers to household are determined by mandatory programs and are projected to increase slightly as a percentage of GDP over the medium term. Domestic interest is calculated based on domestic debt stocks and their associated interest rates. Net domestic financing is added to domestic debt stocks, thereby providing the base for carrying the interest calculation into subsequent periods (Equation 8).

88. The baseline scenario has tax revenue declining to 15.3 percent of GDP in 2000 mainly because of the sharp decline in cocoa taxes and reductions in the effective tariff, τ , owing to tariff reform (Figure 11 and Table 13). The tax ratio recovers to 15.8 percent of GDP in 2002-03 with the recovery in cocoa prices, then declines to 15.6 percent of GDP in 2006-07 as the effective tariff declines and the government's share of cocoa export receipts stabilize at 10 percent. The ratio of domestic interest payments to revenue, equation (5), decreases from 23 percent in 2000 to 12 percent in 2007, but is above projected levels under the original

²² This differs from the original program, which had VAT rate increases of ½ percent over the medium term in order to compensate to reductions in import duty collections owing to tariff reform.

Figure 11. Ghana: Benchmark and Revised Program, 2000-07
(In percent of GDP, unless otherwise specified)



Source: Fund staff estimates.

Table 13. Ghana: Fiscal Sustainability Analysis, 2000-07
(In percent of GDP, unless otherwise specified)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|--------------------------------------|------|------|------|------|------|------|------|------|
| Baseline | | | | | | | | |
| Stock of domestic debt | 21.1 | 20.5 | 20.9 | 20.9 | 20.3 | 19.4 | 18.3 | 17.2 |
| Overall balance (commitment basis) | -7.6 | -6.6 | -5.2 | -4.2 | -3.4 | -2.7 | -2.3 | -1.9 |
| Domestic interest to revenue ratio | 23.1 | 20.6 | 18.7 | 16.6 | 14.9 | 13.6 | 12.7 | 12.1 |
| Net domestic financing | 3.3 | 2.3 | 2.7 | 2.2 | 1.6 | 1.2 | 0.9 | 0.7 |
| Tax revenue | 15.3 | 15.7 | 15.8 | 15.8 | 15.7 | 15.7 | 15.6 | 15.6 |
| Domestic primary balance | 2.5 | 3.0 | 3.2 | 3.3 | 3.3 | 3.4 | 3.4 | 3.3 |
| Revised program | | | | | | | | |
| Stock of domestic debt | 20.2 | 18.9 | 18.6 | 17.8 | 16.5 | 14.7 | 12.9 | 11.0 |
| Overall balance (commitment basis) | -6.7 | -5.7 | -4.3 | -3.2 | -2.2 | -1.6 | -1.0 | -0.5 |
| Domestic interest to revenue ratio | 21.9 | 18.8 | 16.4 | 14.0 | 11.8 | 10.2 | 8.9 | 7.8 |
| Net domestic financing | 2.4 | 1.4 | 1.8 | 1.1 | 0.5 | 0.0 | -0.3 | -0.7 |
| Tax revenue | 16.2 | 16.4 | 16.4 | 16.5 | 16.4 | 16.3 | 16.3 | 16.3 |
| Domestic primary balance | 3.4 | 3.7 | 3.8 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| Domestic debt fund | | | | | | | | |
| Stock of domestic debt | 19.9 | 18.2 | 17.6 | 16.7 | 15.3 | 13.6 | 11.7 | 9.7 |
| Overall balance (commitment basis) | -6.4 | -5.4 | -3.9 | -3.0 | -2.1 | -1.4 | -0.9 | -0.4 |
| Domestic interest to revenue ratio | 21.9 | 18.4 | 15.7 | 13.1 | 11.0 | 9.4 | 8.0 | 6.9 |
| Net domestic financing | 2.0 | 1.1 | 1.4 | 1.0 | 0.4 | -0.1 | -0.5 | -0.8 |
| Tax revenue | 16.2 | 16.4 | 16.4 | 16.5 | 16.4 | 16.3 | 16.3 | 16.3 |
| Domestic primary balance | 3.0 | 3.4 | 3.5 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| External assistance shortfall | | | | | | | | |
| Stock of domestic debt | 21.4 | 20.0 | 20.1 | 19.8 | 18.8 | 17.3 | 15.8 | 14.1 |
| Overall balance (commitment basis) | -6.2 | -5.4 | -4.4 | -3.3 | -2.7 | -2.0 | -1.6 | -1.2 |
| Domestic interest to revenue ratio | 22.2 | 21.3 | 21.1 | 18.8 | 17.1 | 15.0 | 13.4 | 12.1 |
| Net domestic financing | 3.4 | 2.6 | 3.0 | 2.3 | 1.6 | 1.1 | 0.6 | 0.3 |
| Tax revenue | 16.0 | 16.2 | 16.1 | 16.2 | 16.1 | 15.9 | 15.8 | 15.8 |
| Domestic primary balance | 3.1 | 3.5 | 3.6 | 3.8 | 3.8 | 3.7 | 3.7 | 3.7 |
| Higher inflation | | | | | | | | |
| Stock of domestic debt | 19.9 | 18.9 | 18.6 | 17.9 | 16.9 | 15.6 | 14.1 | 12.4 |
| Overall balance (commitment basis) | -7.0 | -6.0 | -4.6 | -3.5 | -2.6 | -1.8 | -1.3 | -0.8 |
| Domestic interest to revenue ratio | 23.9 | 21.3 | 18.8 | 16.5 | 13.9 | 11.9 | 10.2 | 9.0 |
| Net domestic financing | 2.8 | 1.9 | 2.3 | 1.7 | 1.0 | 0.5 | 0.1 | -0.2 |
| Tax revenue | 16.1 | 16.1 | 16.0 | 16.0 | 15.9 | 15.8 | 15.7 | 15.7 |
| Domestic primary balance | 3.2 | 3.5 | 3.5 | 3.6 | 3.5 | 3.6 | 3.5 | 3.5 |
| Higher real interest rates | | | | | | | | |
| Stock of domestic debt | 20.4 | 19.4 | 19.5 | 19.0 | 18.0 | 16.6 | 15.1 | 13.4 |
| Overall balance (commitment basis) | -7.0 | -6.1 | -4.7 | -3.6 | -2.7 | -2.0 | -1.5 | -1.1 |
| Domestic interest to revenue ratio | 23.1 | 20.7 | 18.6 | 16.4 | 14.4 | 12.9 | 11.6 | 10.6 |
| Net domestic financing | 2.6 | 1.8 | 2.2 | 1.6 | 1.0 | 0.5 | 0.2 | -0.1 |
| Tax revenue | 16.2 | 16.4 | 16.4 | 16.5 | 16.4 | 16.3 | 16.3 | 16.3 |
| Domestic primary balance | 3.4 | 3.7 | 3.8 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |

Sources: Ghanaian authorities; and Fund staff estimates and projections.

program. The overall budget on a commitment basis, including grants, never achieves balance as under the original program, remaining 2 percent of GDP in deficit in 2007. Net domestic financing, although declining, remains positive throughout the medium term, reaching 0.7 percent of GDP in 2007. The domestic primary balance never reaches 3.5 percent of GDP, an important target for reducing the stock of domestic debt. In that regard, the domestic debt stock only begins to decline relative to GDP by 2004 and is over 17 percent in 2007, twice the level targeted under the original program.

E. A Fiscal Strategy to Address the 1999 External Shock

89. The sharp decline in international cocoa prices in 1999 has accelerated the government's cocoa reform agenda, with the producers' share of the price rising faster than originally planned and government's cocoa export tax revenue falling. The decline in world cocoa prices is expected to have its greatest impact on cocoa tax revenue in 2000, with projected revenue less than 1 percent of GDP. Measures are needed to address this loss and subsequent losses following from import tariff reform, so as to return to the extent possible to the original fiscal adjustment path.

90. An increase in the VAT rate would be efficient and consistent with the government's policy of moving toward a tax system that encourages saving and investment. At present, Ghana's VAT rate is low in comparison with neighboring countries and with other countries that have a VAT. This analysis therefore assumes an increase in the VAT rate to 12.5 percent early in 2000 as the most efficient way to address the substantial revenue loss in that year. This increase is followed by a further increment to 13 percent in 2003 to compensate for revenue losses from tariff reform in the medium term.

91. The VAT rate increases bring the budget nearly into balance over the medium term, achieving an overall deficit of only 0.5 percent of GDP in 2007 (Figure 11). The domestic primary surplus rises steadily from 3½ to 4 percent of GDP in 2003 and stays at that level afterwards. Net domestic financing becomes negative at about ½ percent of GDP in 2006–07, meaning that the budget allows for retirement of outstanding domestic debt stock by the end of the medium term. Tax revenue recovers to 16½ percent of GDP, below the level reached over the medium term under the original program but enough to bring levels of domestic debt stock and interest substantially closer to original targets. Domestic interest payments as a share of revenue drop below 10 percent in 2006 and below 8 percent in 2007. The stock of domestic debt declines to 11 percent of GDP in 2007, about 10 percentage points below its peak in 2000.

F. Domestic Debt Fund

92. Ghana's domestic interest burden follows mainly from its high domestic interest rates. Ghana's domestic debt stock as a share of GDP is not out of line with other African countries,

but interest payments on this debt are much larger because Ghana's interest rate is much higher (Box 2).²³ In October 1998, the government carried out a National Debt Workshop with the assistance of Debt Relief International. Among its recommendations, the workshop recommended setting up a domestic debt fund with donor contributions to mitigate the burden of domestic debt service.

Box 2. Public Domestic Debt: Selected African Countries, 1998

| | Total revenue | Domestic interest | | Domestic debt stock | | Average interest | Average inflation |
|---------------|---------------|-------------------|-------------------------|---------------------|-------------------------|------------------|-------------------|
| | (In % of GDP) | (In % of GDP) | (In % of total revenue) | (In % of GDP) | (In % of total revenue) | | |
| Benin | 15.5 | 0.2 | 1.3 | 4.9 | 32.0 | 4.1 | 2.9 |
| Burkina Faso | 13.1 | 0.2 | 1.5 | 7.0 | 53.5 | 2.8 | 2.5 |
| Côte d'Ivoire | 21.4 | 0.5 | 2.3 | 20.8 | 97.4 | 2.4 | 3.0 |
| Malawi | 17.3 | 2.2 | 12.7 | 8.1 | 8.1 | 27.1 | 17.5 |
| Mali | 16.0 | 0.0 | 0.0 | 4.1 | 25.9 | 0.0 | 1.8 |
| Niger | 9.0 | 0.1 | 1.1 | 12.5 | 138.9 | 0.8 | 3.0 |
| Senegal | 16.7 | 0.3 | 1.8 | 11.4 | 68.4 | 2.6 | 2.4 |
| Togo | 14.3 | 0.1 | 0.7 | 15.9 | 111.3 | 0.6 | 2.8 |
| Ghana | 18.3 | 5.2 | 28.4 | 19.3 | 105.5 | 26.9 | 15.5 |

Source: National authorities and IMF staff calculations.

93. The domestic debt fund examined in this analysis comprised an additional contribution of US\$50 million annually from donors collectively during 2000–2002. This amount of support could be expected to have a significant impact on domestic debt and poverty reduction, without straining the limits for liquidity creation and absorptive capacity of the economy. It is assumed that 50 percent of the debt service savings are used for additional priority expenditures. In this light, priority spending was increased by half the amount of the fund, that is US\$25 million annually over 2000–2002.

²³ The high real interest rates in Ghana are a result of past expansionary fiscal policies, which placed a heavy burden on monetary policy. Real interest rates are expected to decline gradually as debt levels decline and confidence increases.

94. The saving in domestic interest achieved with the donor-financed domestic debt fund lowers the overall deficit and net domestic financing in all years of the medium term (Figure 12). The stock of domestic debt drops below 10 percent of GDP in 2007, an objective of the original program. Additional priority spending equal to half of the savings in domestic interest reduces by half the improvement in the domestic primary surplus achieved under the program over the baseline in 2000–2002.

G. Shortfall in External Assistance

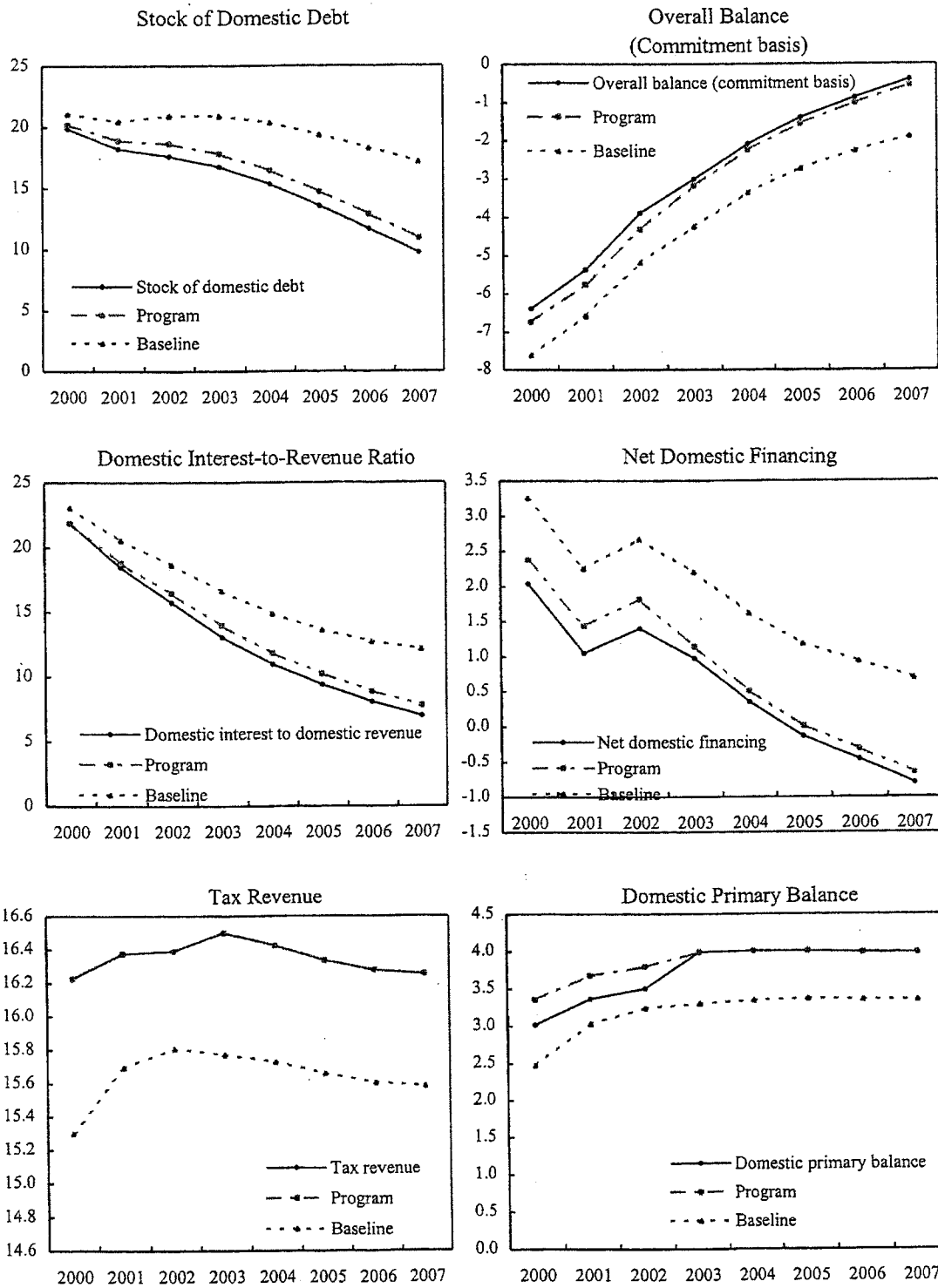
95. The fiscal strategy for addressing the effects of the terms of trade shock in 2000 relies on both domestic tax measures and additional external assistance. An examination of the impact of a shortfall in external assistance on medium-term fiscal performance usefully illustrates the importance of this assistance. This simulation was carried out by assuming shortfalls (against the baseline) of US\$200 million each in 2000 and 2001, US\$150 million each in 2002 and 2003, US\$100 million each in 2004 and 2005, and US\$50 million each in 2006 and 2007. These shortfalls were generated by equiproportional reductions of both program and project grants and loans in each year. Because the balance of payments is left unchanged, exchange rates are expected to adjust so that imports decline in line with the shortfall in external assistance. Shortfalls in program assistance (g^* in equation (8)), however, create a gap in budget financing, which was assumed to be closed by additional domestic financing. Because a shortfall in project assistance reduces spending by the same amount, it has no effect on domestic financing.²⁴

96. The shortfall in external assistance causes fiscal performance to deteriorate, substantially nullifying the fiscal measures examined above for addressing the effects of the external shock in 1999 (Figure 13). The only exception is the overall budget balance which follows the path under the revised program, owing to the reduction in the deficit from lower foreign-financed capital expenditure. Notwithstanding this exception, net domestic financing is higher than under the revised program because of the need to make up for the shortfall in external program assistance and the loss in import tariff revenue caused by lower imports.²⁵ This additional domestic financing raises the stock of domestic debt above levels under the revised program. The ratio of domestic interest to revenue exceeds levels under revised program and the baseline scenario for most of the medium term because of both higher interest payments and lower tariff revenue. Lower tariff revenue causes the domestic primary surplus to fall short of the levels achieved under the revised program.

²⁴ Foreign-financed capital expenditure, denoted f in the model, does not appear in equation (8).

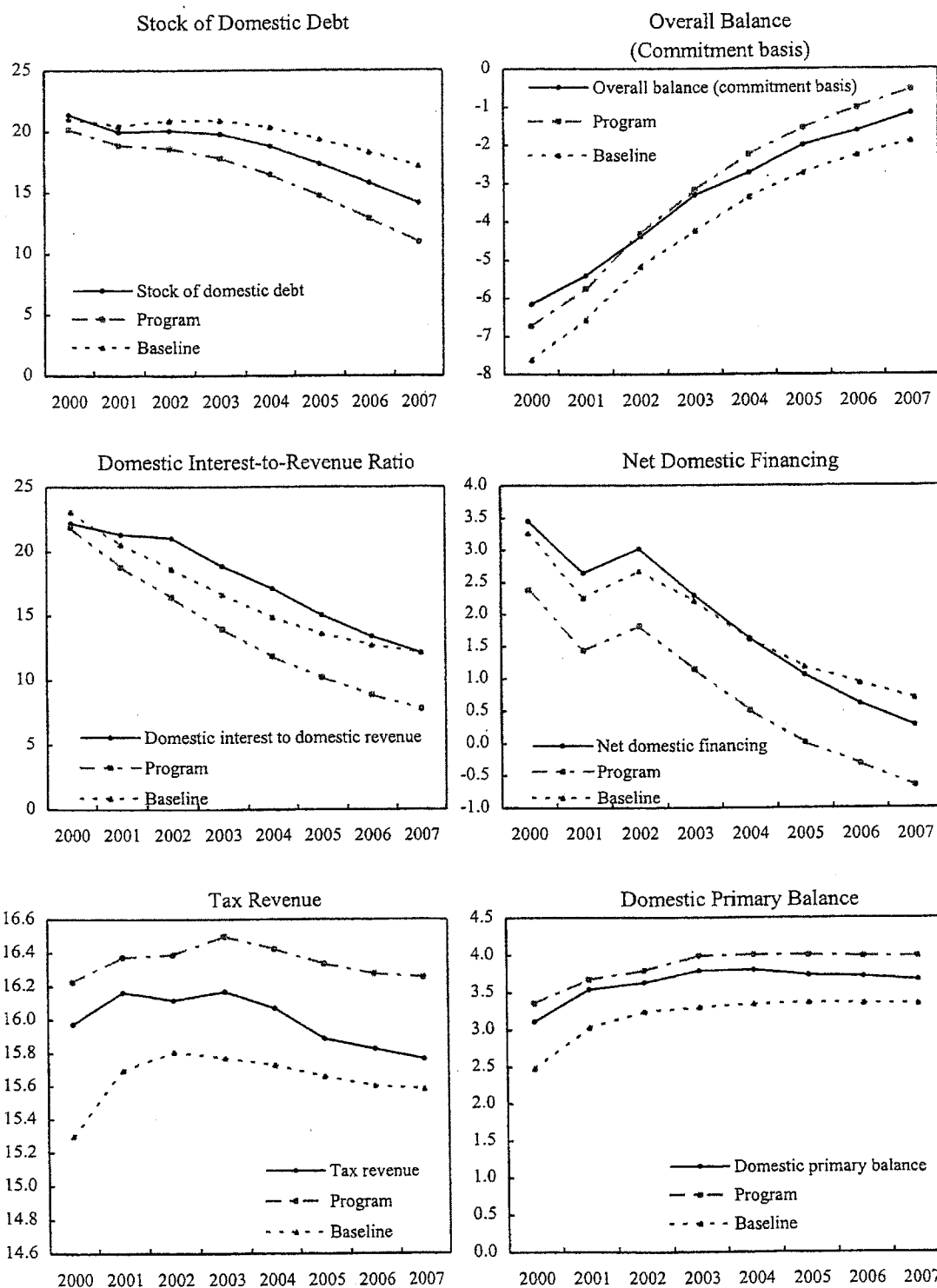
²⁵ To the extent lower imports, which were expected to be financed by foreign financing, are exempt from tariffs, the fall in tariff revenue will be less than assumed in the simulation.

Figure 12. Ghana: Domestic Debt Fund, 2000-07
(In percent of GDP, unless otherwise specified)



Source: Fund staff estimates.

Figure 13. Ghana: External Assistance Shortfall, 2000-07
(In percent of GDP, unless otherwise specified)



Source: Fund staff estimates.

H. Resilience of Program to Shocks

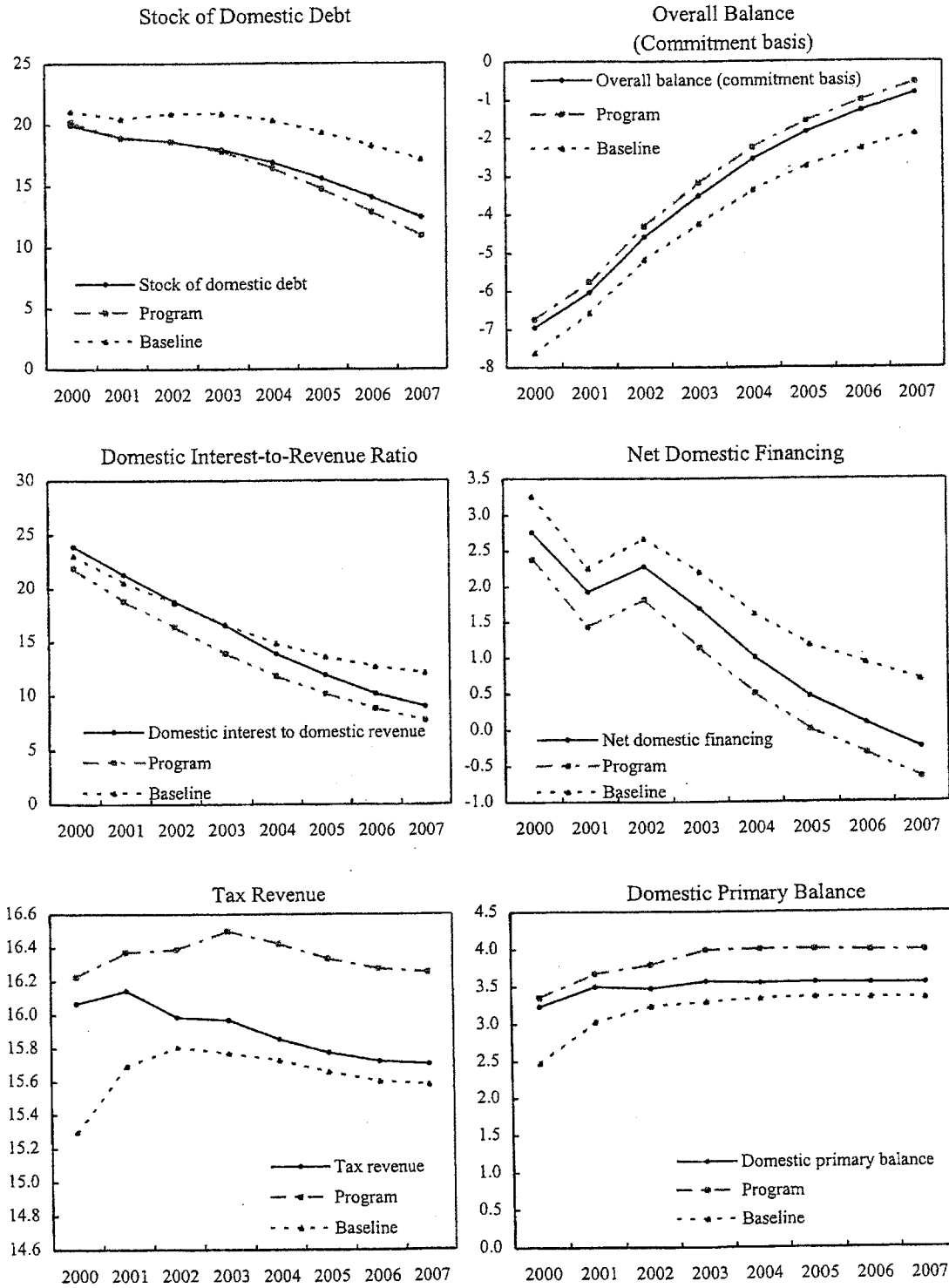
97. Given the impact of external developments in 1999 on fiscal performance, the medium-term fiscal sustainability analysis was used to examine the resilience of the revised program to shocks—specifically, higher inflation and interest rates.

98. Assuming an inflation path that is 4 percentage points higher than the baseline in 2000-02, and thereafter converges gradually to the baseline path, adversely affects medium-term fiscal sustainability (Figure 14). The ratio of tax revenue to GDP declines from program levels because trade taxes are not linked to GDP and therefore decline as a proportion of GDP owing to inflation.²⁶ Because expenditures decline less as a percentage of GDP with higher inflation, the domestic primary surplus is lower than under the program, remaining fairly level at 3½ percent of GDP from 2001, about ½ percentage point below the revised program. Correspondingly, the overall deficit and net domestic financing are higher, although they are below 1 percent of GDP and negative, respectively, by 2007. The ratio of domestic interest to revenue rises dramatically, exceeding baseline levels through 2002, as increases in domestic interest owing to higher nominal interest rates exceed inflationary increases in revenue. The ratio of the stock of domestic debt to GDP is lower in 2000 than under the program because higher inflation affects GDP immediately. However, higher domestic financing quickly takes over, resulting in a larger stock of domestic debt by about 1½ percentage points of GDP in 2007.

99. Real interest rates that are 2 percentage points above those in the program roughly halve the improvement in key fiscal variables achieved under the revised program over the baseline scenario—for example, the overall budget deficit rises from 4.3 percent of GDP in 2002 under the revised program to 4.7 percent of GDP, but remains less than 5.2 percent in the baseline scenario (Figure 15). Similarly in 2002, net domestic financing increases from 1.8 percent of GDP under the revised program to 2.2 percent, remaining below 2.7 percent in the baseline scenario. The stock of domestic debt declines to 13½ percent of GDP in 2007, between 11 percent under the revised program and 17 percent in the baseline scenario. Higher interest rates virtually eliminate any improvement in the domestic interest-to-revenue ratio through 2003 and leave the ratio above 10 percent in 2007. As expected, tax revenue and the domestic primary surplus are unaffected by higher real interest rates.

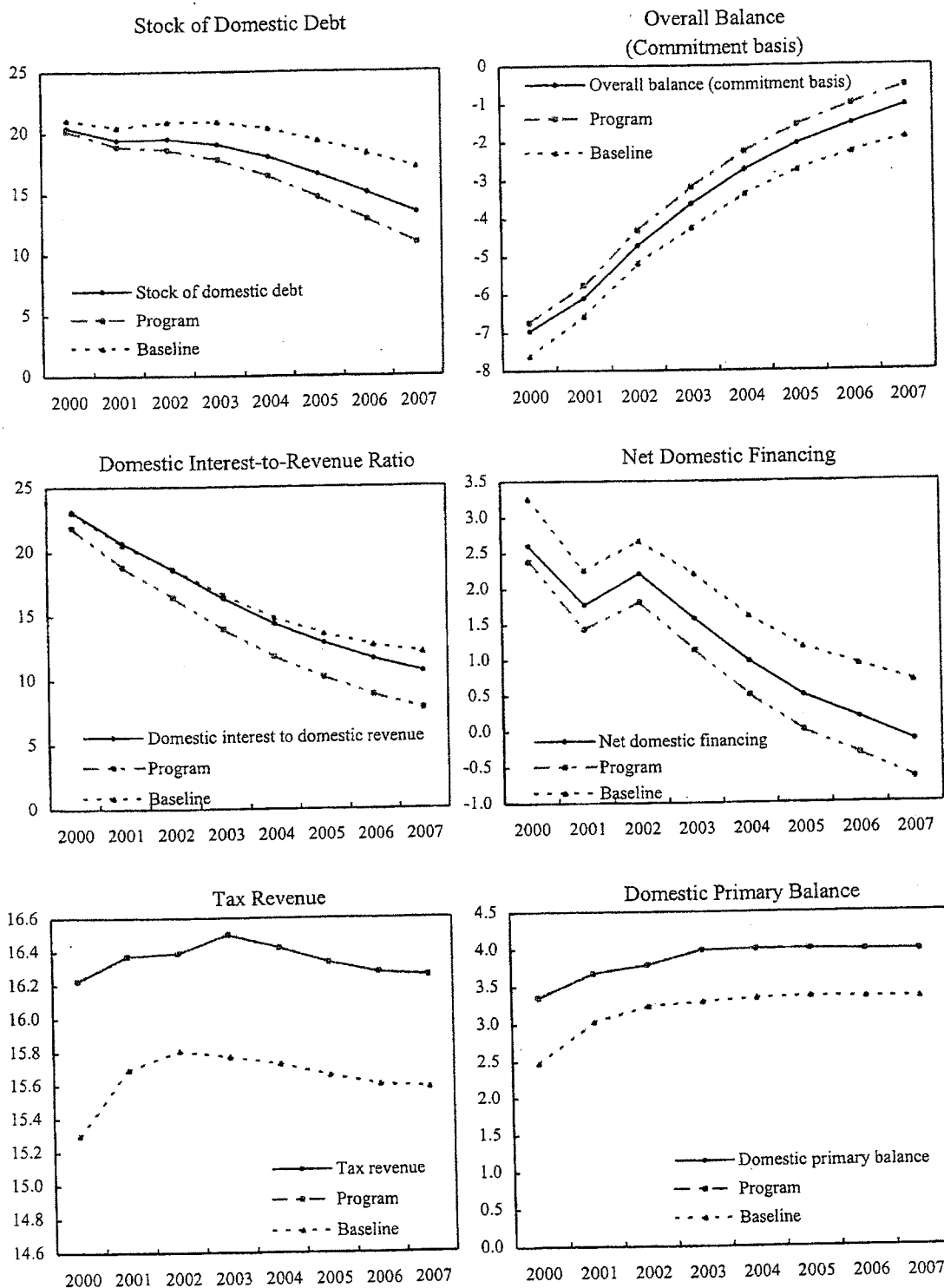
²⁶ Higher inflation causes the exchange rate to depreciate according to equation (10). A more depreciated exchange rate raises the values in domestic currency of import duties and cocoa export taxes, but not enough to outweigh the effect on their ratio to GDP of higher nominal GDP owing to higher inflation.

Figure 14. Ghana: Higher Inflation, 2000-07
(In percent of GDP, unless otherwise specified)



Source: Fund staff estimates.

Figure 15. Ghana: Higher Real Interest Rates, 2000-07
(In percent of GDP, unless otherwise specified)



Source: Fund staff estimates.

I. Concluding Observations

100. The medium-term fiscal sustainability analysis provides a useful quantification of the impact of the shocks experienced in 1999 on fiscal performance through 2007. It showed that, without compensating measures, domestic interest and debt absorbed substantial revenue and financial capital, crowding out public expenditures and private investment over the medium-term. It also permitted precise calculation of the magnitude of measures needed to bring fiscal performance back on track for achieving the objectives of the government's economic program—for example, the VAT rate increases needed to compensate for the sharp revenue decline in 2000 and subsequent revenue losses from tariff reform during the medium term.

IV. GHANA'S SOCIAL INSURANCE SYSTEM: OPERATION AND POLICY ISSUES²⁷

A. Introduction

101. The Social Security and National Insurance Trust (SSNIT) is the government agency with responsibility for collecting social insurance contributions from enterprises and making social insurance payments to retired or disabled workers and their dependents and survivors. From 1965 through 1990, Ghana's retirement pension system operated as a provident fund and, in 1991, shifted to a social insurance system.²⁸ The total investment portfolio of SSNIT was C 1,274 billion at the end of 1998, an increase of 28 percent from the previous year, amounting to over 7 percent of GDP and making SSNIT by far the single largest source of financial capital in Ghana.

102. Ghana's social insurance system is subject to an independent actuarial evaluation every three years. The last such evaluation was conducted in 1996 and concluded that SSNIT is actuarially sound and will accumulate reserve funds for at least thirty years. This evaluation pointed out that SSNIT's actuarial soundness is typical of a new social insurance program that has not had time to mature. In particular, SSNIT is in the transient stage of moving from a provident fund requiring full funding to a social insurance system requiring a lower degree of funding. Further, because pensions only started to be awarded in July 1991, the number of pensioners is low and expenditures are well below levels typical of a mature program. Therefore, despite its current actuarial soundness, SSNIT faces significant challenges as the largest source of financial capital in an environment with limited investment opportunities and increasing expenditures.

B. Structure and Operation of SSNIT

Background

103. The fundamental purpose of the 1991 social security law was to shift Ghana's social security system from a provident fund paying only lump-sum benefit to a pension system

²⁷ Prepared by Anthony Pellechio.

²⁸ SSNIT was established as a provident fund according to the 1965 Social Security Act (Act No. 279) and the 1972 Social Security Decree (N.R.D.C. 127). It was converted to a social insurance system by the Social Security Law of 1991 (P.N.D.C.L. 247), with the conversion date on July 1, 1991 when pension payments began.

paying monthly benefits to members throughout their retirement. The law allowed for wider coverage, opening participation in the system to all employees in the formal and informal sectors, including self-employed persons who opt to join. The law provides a basic pension for retired workers, benefits for survivors of workers, and invalidity benefits.²⁹

Benefit structure

104. A worker who has paid 240 months of contributions and reached 60 years of age can receive a full retirement benefit.³⁰ A worker can retire as early as age 55 with a benefit equal to 60 percent of the full retirement benefit; the benefit for retirement between ages 55 and 60 is scaled based on age. A worker can elect to receive a lump sum amount equal to the present value of 25 percent of his monthly benefit.³¹ If so, the worker receives 75 percent of his benefit amount as a monthly pension.

105. A worker qualifies for an invalidity benefit if he contributed to the fund for 12 months within the 36-month period before becoming invalid. The invalidity benefit is calculated in the same manner as the retirement benefit.

106. Survivors of workers who contributed to the fund for 240 months before dying are eligible to receive a lump sum equal to the present value of the worker's monthly pension.³² A prorated lump sum is paid if the worker dies before contributing for 240 months.

107. An important feature of the law was its provision for wage indexation of benefits by requiring SSNIT to "review annually the pension payment based on adjustment in salaries and wages of members". The pension increases based on these reviews have been: 21 percent in

²⁹ These benefits cover three of the nine standards of social security contingencies sanctioned by the International Labor Organization. The other contingencies are unemployment, injury, sickness, medical care, maternity, and childcare.

³⁰ The full retirement benefit equals 50 percent of the annual average for the three years of highest earnings, plus 1/8 percent for every month in which contributions were paid in excess of 240 months, and is limited to a maximum of 80 percent of the annual average earnings and a minimum of C 5,000 per month.

³¹ This present value equals the value of a certain annuity for 12 years discounted at the prevailing real treasury bill rate.

³² This payment equals the present value of a annuity over 12 years or the number of months remaining at the time of death before the deceased worker would have reached age 72.

1992, 86 percent in 1993, 45 percent in 1994, 10 percent in 1995, 30 percent in 1996, 25 percent in 1997, 14 percent in 1998, and 12.5 percent in 1999.³²

Contributions

108. Under the period of operation as a provident fund before 1991 and as a social insurance system since then, SSNIT has been financed by monthly contributions at the combined rate of 17.5 percent of monthly earnings—12.5 percent from employers and 5 percent from employees. The amount of monthly earnings subject to SSNIT contribution rates is the total amount paid to workers during the month, without any maximum limit meaning that all earnings in employment covered by social security are subject to contributions.

Coverage

109. SSNIT covers about 750,000 workers in an economically active population of 8 million. Public servants comprise the majority of covered workers in the SSNIT program. Individuals formally employed in the private sector are also required to participate. This leaves informal workers who make up over 80 percent of the economically active population outside the system.

C. Actuarial Evaluation of SSNIT Operations

110. Ghana's social insurance program is subject to actuarial evaluation every year by the Actuarial Department of SSNIT and once every three years by an independent consulting actuary, whose latest report was published in May 1996. This report presents projections of the annual amounts of total contributions and benefit payments through 2005, along with the reserves that would be accumulated. The assumptions required for these projections can be grouped into three categories—demographic, economic, and programmatic—which are summarized below.

Demographic

111. The scarcity of recent and reliable data on demographic characteristics necessitates simple assumptions in this area. Specifically, the demographic characteristics of contributing workers, such as marital status and average numbers of dependents, are taken to be similar to those shown in recent years. Life expectancy is assumed to increase slowly.

³² Adjei (1999).

Economic

112. An important economic assumption is the increase in average earnings over the projection period. The annual increases in earnings assumed for 1996-99 in the last outside actuarial evaluation proved to be much less than actual increases. This resulted from the surge in inflation following the substantial expenditure overruns that occurred in the second half of 1996 after the evaluation was completed. Expected earnings growth after 1999 is more in line with projections in the last actuarial review.

113. The number of contributors was projected to increase by 4.4 percent in 1996 and decline slowly afterwards, with an annual average rate of increase of slightly below 3 percent for the 1995-2007 period (Table 14). The assumptions for projected numbers of contributors would need to be altered if coverage is extended to the informal sector.

Programmatic

114. All pensions were assumed to be adjusted on an annual basis for the increase in the cost of living. Because a higher proportion of workers accumulate the minimum number of months of paid contributions, the rate at which pensions will be awarded increases rapidly. The rates at which invalidity pensions and death benefits will be awarded remain stable because of the low number of months of contributions required for eligibility. Based on these rates of pension awards, the number of pensioners rises through the projection period. From 1998 to 2007, the number of age pensioners is projected to increase over three-fold.

Projected costs

115. The total amount of projected benefit payments and administrative expenses of SSNIT, expressed as a percentage of insured earnings, represents the contribution rate needed to cover these expenses. Total expenditures of SSNIT are projected to increase rapidly from 5.3 percent of insured earnings in 1995 to 9.8 percent in 2005, which is still well below the current contribution rate of 17.5 percent (Table 15). The actuarial review did not recommend a reduction in the contribution rate because it will be needed as the cost of the system continues to increase rapidly. By retaining the current contribution rate, the system will be financially sound over the projection period.

116. An important demographic determinant of the cost of social security is the ratio of pensioners to contributors, estimated to be 2 percent in 1999, a very low figure, but projected to increase five-fold by 2007 (Figure 16). This is the principal factor underlying the growth in the ratio of SSNIT expenses to insured earnings, which is projected to rise from 5 percent in 1999 to 14 percent in 2007.

Table 14. Ghana: SSNIT—Contributions and Benefits, 1995-2007

(In billions of cedis, unless otherwise specified)

| Year | Number of Contributors (In thousands) | Insured Earnings | Number of Pensioners 1/ | | Pension Payments | | Lump Sum Payments | | |
|------|--|------------------|-------------------------|------------|------------------|------------|-------------------|------------|-----------|
| | | | Old-Age | Invalidity | Old-Age | Invalidity | Old-Age | Invalidity | Survivors |
| 1995 | 643 | 661 | 13,384 | 125 | 4,447 | 39 | 5,804 | 16 | 3,101 |
| 1996 | 661 | 972 | 18,855 | 165 | 8,923 | 69 | 6,789 | 31 | 4,986 |
| 1997 | 702 | 1,142 | 24,014 | 219 | 14,359 | 107 | 8,600 | 43 | 8,994 |
| 1998 | 726 | 1,328 | 29,084 | 291 | 21,939 | 156 | 12,900 | 63 | 9,975 |
| 1999 | 751 | 1,554 | 34,555 | 366 | 31,753 | 222 | 15,841 | 83 | 13,236 |
| 2000 | 781 | 1,939 | 40,330 | 444 | 44,565 | 311 | 19,154 | 106 | 17,290 |
| 2001 | 824 | 2,250 | 46,585 | 520 | 64,648 | 454 | 24,272 | 148 | 24,408 |
| 2002 | 865 | 2,599 | 53,898 | 595 | 86,739 | 603 | 32,964 | 198 | 32,541 |
| 2003 | 900 | 2,973 | 62,250 | 672 | 114,510 | 798 | 40,124 | 254 | 41,960 |
| 2004 | 927 | 3,368 | 71,134 | 749 | 148,463 | 1,026 | 47,526 | 288 | 49,105 |
| 2005 | 955 | 3,816 | 80,435 | 826 | 189,537 | 1,291 | 55,844 | 327 | 58,005 |
| 2006 | 978.4 | 4,303 | 89,960 | 903 | 237,621 | 1,597 | 62,964 | 368 | 68,250 |
| 2007 | 1002.9 | 4,852 | 99,546 | 979 | 293,629 | 1,949 | 70,992 | 415 | 80,230 |

Source: SSNIT.

1/ Average number paid in year.

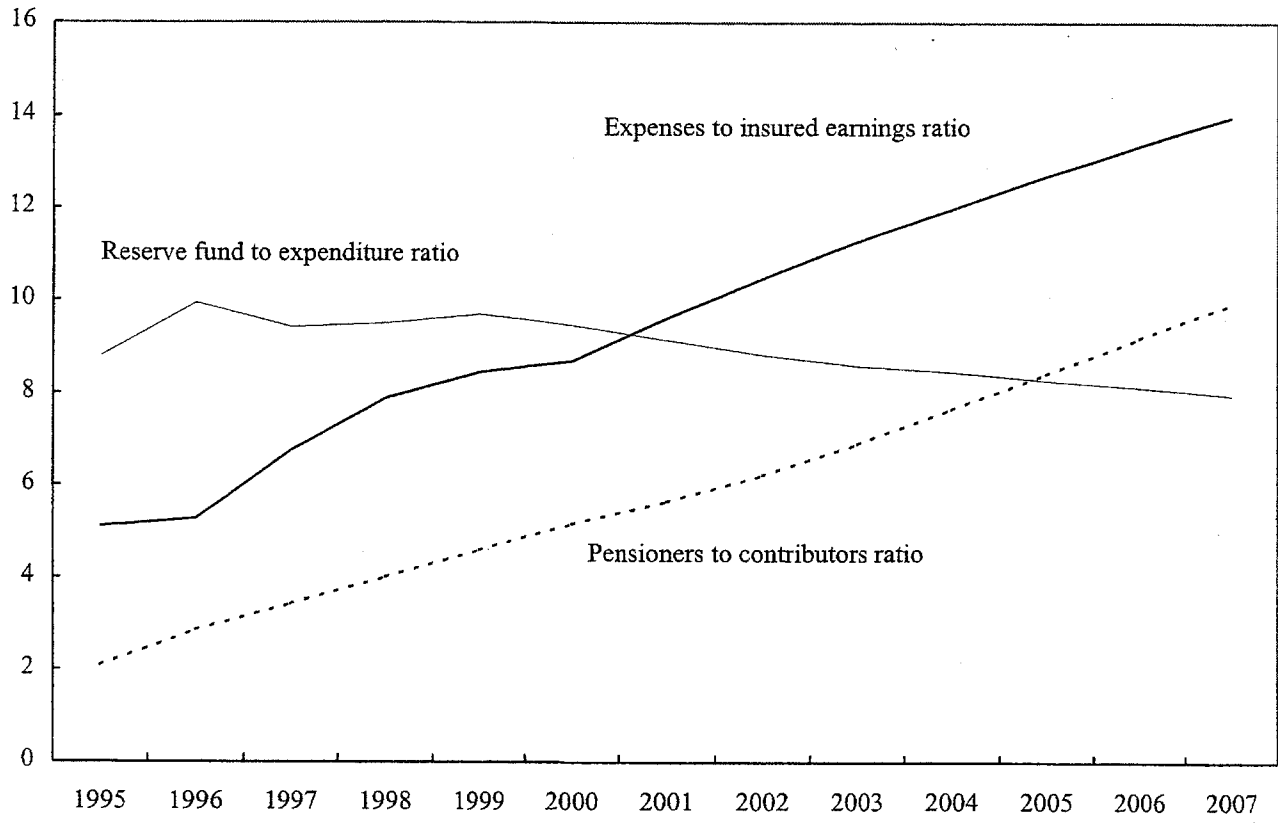
Table 15. Ghana: SSNIT—Total Expenditures, 1995-2007

| Year | Benefit Payments | | Admin. Expenses | Total Expenses | Benefit Payments | | Admin. Expenses | Total Expenses | |
|------|------------------|-----------|-----------------|----------------|------------------|-----------|-----------------|----------------|------|
| | Pensions | Lump Sums | | | Pensions | Lump Sums | | | |
| 1995 | 4,486.3 | 8,920.8 | 20,299.4 | 33,706.5 | 0.7 | 1.3 | 2.0 | 3.1 | 5.1 |
| 1996 | 8,992.1 | 11,805.9 | 30,447.7 | 51,245.7 | 0.9 | 1.2 | 2.1 | 3.1 | 5.3 |
| 1997 | 14,466.1 | 17,637.0 | 44,998.3 | 77,101.4 | 1.3 | 1.5 | 2.8 | 3.9 | 6.8 |
| 1998 | 22,095.0 | 22,937.7 | 59,770.8 | 104,803.5 | 1.7 | 1.7 | 3.4 | 4.5 | 7.9 |
| 1999 | 31,975.2 | 29,159.8 | 70,164.0 | 131,299.0 | 2.1 | 1.9 | 3.9 | 4.5 | 8.5 |
| 2000 | 44,876.3 | 36,549.8 | 87,015.9 | 168,442.0 | 2.3 | 1.9 | 4.2 | 4.5 | 8.7 |
| 2001 | 65,102.0 | 48,828.2 | 102,435.0 | 216,365.2 | 2.9 | 2.2 | 5.1 | 4.6 | 9.6 |
| 2002 | 87,341.7 | 65,702.2 | 119,330.5 | 272,374.4 | 3.4 | 2.5 | 5.9 | 4.6 | 10.5 |
| 2003 | 115,307.6 | 82,338.6 | 137,700.0 | 335,346.2 | 3.9 | 2.8 | 6.6 | 4.6 | 11.3 |
| 2004 | 149,488.6 | 96,919.0 | 157,281.8 | 403,689.4 | 4.4 | 2.9 | 7.3 | 4.7 | 12.0 |
| 2005 | 190,827.6 | 114,175.1 | 179,546.2 | 484,548.9 | 5.0 | 3.0 | 8.0 | 4.7 | 12.7 |
| 2006 | 239,218.1 | 131,581.4 | 203,666.1 | 574,465.6 | 5.6 | 3.1 | 8.6 | 4.7 | 13.4 |
| 2007 | 295,578.2 | 151,637.0 | 230,611.0 | 677,826.2 | 6.1 | 3.1 | 9.2 | 4.8 | 14.0 |

(In billions of cedis)

(In percent of insured earnings)

Figure 16. Ghana: Dependency and Expense Ratios for SSNIT, 1995-2007
(In percent)



Projected operation of SSNIT

117. SSNIT is forecast to accumulate a reserve that increases from C 1.3 trillion at the end of 1998 to C 5.7 trillion by the end of 2005 (Table 16). This additional reserve will be constituted from investment income as well as contributions. An important measure for assessing financial soundness is the ratio of SSNIT's reserve fund to projected expenditures, which is falling steadily to a level of only 8 in 2007. °

118. The increase in SSNIT's reserve fund to C 6.2 trillion at the end of 2005, equivalent to 12 percent of projected GDP, clearly indicates its dominant role in Ghana's economic development. The size of this accumulation of financial capital requires constant examination of this role.

D. SSNIT's Portfolio and Investment Policy

119. The 1991 social security law assigns responsibility for management of SSNIT's portfolio to the Board of Directors.³³ The only investment policy in the law is standard language regarding conflict of interest disqualification for Board members. SSNIT issued an investment policy in December 1994, which established six requirements: high yield, safety, liquidity, diversification, maintenance of asset value, and harmony with the public interest. This policy has two stated objectives: (a) to maintain a long-term optimum fund ratio; and (b) to provide investments which are development oriented. The policy generally describes the need for long-range investments and proposes a 2:1 ratio of fixed to non-fixed income assets.

120. Until 1986, SSNIT was required to invest its funds in designated government stock yielding about 6 percent, which caused the social security system to become severely undercapitalized. Since then, SSNIT has been free to diversify its portfolio and has purchased short-term high-yielding treasury bills, equity shares in businesses, real estate, and other investment instruments. SSNIT is a major participant in the Ghana Stock Exchange. It also provides medium and long-term corporate loans at interest rates below the commercial bank lending rate but above the treasury bill rate. SSNIT also makes social investments, such as building health facilities for poor communities and providing student loans (Box 3).

³³ The Board comprises 14 members appointed for three year terms as follows: the Director General of SSNIT, four persons, including the Chair, appointed by the government, one representative each of the Minister of Finance, Bank of Ghana, Minister of Labor, Civil Service Association, and National Association of Teachers, two representatives of the Employers' Association, and two representatives of the Trade Union Congress.

Table 16. Ghana: SSNIT—Projected Operations , 1995-2007

(In billions of cedis, unless otherwise specified)

| Calendar Year | Income | | Yield Rate | Expenditure | Net Income | Revaluation | Fund at End of Year | | |
|---------------|---------------|------------|------------|-------------|------------|-------------|---------------------|-------|----------|
| | Contributions | Investment | | | | | | Other | Total |
| 1995 | 115.65 | 37.32 | 1.28 | 154.25 | 0.0972 | 33.71 | 120.54 | 92.09 | 509.06 |
| 1996 | 170.06 | 75.72 | 3.85 | 249.63 | 0.1306 | 51.25 | 198.38 | 18.74 | 726.18 |
| 1997 | 199.84 | 112.32 | 9.81 | 321.97 | 0.1395 | 77.10 | 244.87 | 25.10 | 996.15 |
| 1998 | 232.46 | 121.89 | 2.94 | 357.29 | 0.1150 | 104.80 | 252.49 | 25.25 | 1,273.89 |
| 1999 | 271.87 | 147.86 | 3.02 | 422.75 | 0.1100 | 131.30 | 291.45 | 29.15 | 1,594.49 |
| 2000 | 339.30 | 176.39 | 3.10 | 518.79 | 0.1050 | 168.44 | 350.35 | 35.03 | 1,979.87 |
| 2001 | 393.75 | 206.85 | 3.19 | 603.79 | 0.1000 | 216.37 | 387.42 | 38.74 | 2,406.03 |
| 2002 | 454.78 | 249.72 | 3.27 | 707.77 | 0.1000 | 272.37 | 435.40 | 43.54 | 2,884.97 |
| 2003 | 520.27 | 297.74 | 3.36 | 821.37 | 0.1000 | 335.35 | 486.02 | 48.60 | 3,419.59 |
| 2004 | 589.47 | 351.25 | 3.45 | 944.17 | 0.1000 | 403.69 | 540.48 | 54.05 | 4,014.12 |
| 2005 | 667.87 | 410.58 | 3.55 | 1,082.00 | 0.1000 | 484.55 | 597.45 | 59.74 | 4,671.31 |
| 2006 | 753.02 | 476.06 | 3.64 | 1,232.72 | 0.1000 | 574.47 | 658.25 | 65.83 | 5,395.39 |
| 2007 | 849.03 | 548.10 | 3.74 | 1,400.87 | 0.1000 | 677.83 | 723.04 | 72.30 | 6,190.73 |

Source: SSNIT.

Box 3. SSNIT's Student Loan Program

The student loan program under SSNIT is unique and innovative. The program began in 1988 and permits Ghanaian students enrolled in higher education to receive loans to finance some of the cost. Students accepted by institutions of higher learning must have three guarantors who have contributed to SSNIT for at least five years. The student is responsible for repayment of the loan. Interest is charged at the average treasury bill rate. The student is currently responsible for an interest rate of 6 percent rate, with the government making up the remainder. Upon employment, the student may repay the loan in a lump sum or assign normal SSNIT contributions for loan repayment over five years. SSNIT absorbs the cost of administration. One problem has been the late payment of interest by the government. A major obstacle to recovery of student loans is the low level of job placement for graduates from tertiary institutions.

121. In 1997, SSNIT had 46 percent of its investment in fixed and 54 percent in nonfixed income investments. Fixed income assets, in particular, treasury bills, have provided high yields. Yields on non-fixed assets, especially real estate and nonlisted equities, have been disappointing. No unlisted equity has paid dividends, while 14 of 16 listed companies in which SSNIT holds equity have. As a result, SSNIT is shifting toward an asset allocation based on returns and away from development.

E. Policy Issues Facing SSNIT

Benefit manipulation

122. Ghana's defined-benefit plan, where contributors are entitled to a benefit according to a formula based on a worker's age, years of contribution, and some measure of earnings, is typical of social insurance systems. However, Ghana's benefit formula depends heavily on a relatively short period, specifically three years, of earnings which is vulnerable to abuse by arrangements for paying abnormally high earnings for three years. These three years, given the requirement for payment of contributions over a 20 year period, need not be consecutive nor occur just before retirement. Nonetheless, the potential for manipulation of the benefit formula to maximize pension payments can result in a substantial difference between the total amount a worker contributes plus interest and the total amount received, with unintended and inequitable variations in these differences among workers. Although the stated intention of defined-benefit plans is to redistribute income from high to low-wage workers, evidence from industrial countries reveals that in practice these plans can be regressive.

123. Benefits can be more tightly linked to contributions, without fully funding the system as is the case with a provident fund, in order to reduce manipulation of the benefit calculation and other distortions under a defined-benefit plan, and ensure financial viability over the very long term.

Distortionary impact of contributions and linkage between contributions and benefits

124. The extent to which the benefit formula can be manipulated to yield pension payments out of line with contributions on behalf of an individual is closely related to whether contributions are regarded as a tax or forced savings. The closer the link between the benefit payments and contributions, the less contributions are seen as a tax and, therefore, as a distortion to employment. The perception of contributions as savings may limit political pressure for generous social insurance programs.

125. SSNIT has experienced delays in the payment of contributions for public servants by the government. Delayed contributions from the government constitute interest free financing of the budget, which is significant given the size of the public service in the workforce covered by SSNIT.³⁴ This subsidy to the budget comes at the expense of interest income from SSNIT's reserve fund.

Adverse incentives for retirement and coverage

126. The current specification of the minimum retirement benefit provides strong incentives for workers eligible for the minimum to retire early and take the lump sum, because they will still receive the same monthly pension. In other words, early retirement and a lump sum payment entail no sacrifice in the monthly pension payment when it is at the minimum. The incentives to retire early and take the lump sum exist, although to a lesser degree, as a worker's monthly pension rises above the minimum.

127. Eligibility for full retirement benefits at age 60 and reduced benefits at age 55 is relatively early. The usual argument for low retirement age is the lower life expectancy in countries like Ghana. However, this argument relies on life expectancy at birth when life expectancy at the time of retirement is the relevant concept. The option to take a quarter of the retirement pension in a lump sum makes the measurement of life expectancy at retirement and adjustment of the lump sum calculation for this life expectancy critical.

³⁴ A penalty accrues of 3 percent per month for late payment of contributions, but the government is exempt.

128. SSNIT covers about 10 percent of the economically active population, which raises the legitimate issue of expansion of coverage, mainly to the informal sector. A report was prepared for SSNIT in 1997 examining the extension of coverage to the informal sector.³⁵ The survey results in this report showed that a large majority of a sample of workers in the informal sector would be interested in joining a new SSNIT plan for saving for retirement pensions, purchase of a house or land, and children's education. However, such innovations have to be approached cautiously because the opportunities under the current system to receive pension payments that far exceed contributions may be considerably increased by the sporadic patterns of income in the informal sector and options for early withdrawal of benefits for nonretirement purposes. Therefore, the informal sector should be covered under different terms than presently apply to the formal sector—for example, different contribution rates, eligibility requirements, and benefit formulas.

Compliance

129. The current indebtedness of delinquent contributors amounts to 10 percent of SSNIT's reserve fund, a very high delinquency ratio. An important contributing factor is low penalty rates that make it attractive for companies to use worker contributions as low-interest loans. Although the law empowers SSNIT to prosecute delinquents, it has not done so owing to concerns about the employment security of covered workers. SSNIT elected to follow the not wholly satisfactory course of negotiating with indebted employers. In view of the shortcomings of this approach, a new policy of prosecuting delinquent employers in the third month of default was recently introduced and has proven effective in improving compliance.³⁶ The success of this policy notwithstanding, the underlying causes of noncompliance need to be addressed, in particular, the lack of an appropriate interest charge for late contributions.

Costly administration

130. Administrative expenses are high at 4½ percent of insured earnings in 1999 over 25 percent of contributions which is very high. The cost of administration needs scrutiny, especially as the system matures and benefit payments comprise a larger portion of contributions.

³⁵ Maxwell Stamp (1997).

³⁶ Adjei (1999).

SSNIT's role in the domestic financial market

131. The size of SSNIT's reserve fund relative to Ghana's financial market raises several issues. An important one is SSNIT's potential for influencing, even setting, asset prices. The recent accumulation of substantial reserve funds may be a factor contributing to the stock market's strong performance and SSNIT's purchases of assets through the government's divestiture program at higher prices than other bidders.

132. SSNIT's reserve fund represents virtually the entire source of long-term funding in Ghana. In 1998, SSNIT's total assets amounted to about 42 percent of banking system assets, and its inflow of funds was C 253 billion, approximately 55 percent of the banking system's increase in deposits. As the primary source of long-term credit, SSNIT's investment decisions, in addition to being important for its own financial soundness, are important for the functioning of the financial system.

133. The size and potential influence of SSNIT's reserve fund in Ghana's financial markets requires a careful balancing of the need to preserve SSNIT's independence from government interference and the need to ensure that SSNIT does not use its influence to interfere with the normal functioning of markets.

134. It is likely that SSNIT may be too large to be confined to investment in Ghana's domestic financial market alone. In order to meet its expressly established requirements, in particular, high yield, safety, and diversification, consideration could be given to allowing SSNIT to invest a portion of its reserve funds in foreign assets.

Need for systemic reform

135. SSNIT's role as the only social insurance program providing an earnings-related pension subject to a minimum amount for the formal sector may be appropriate as the first step in the development of Ghana's pension system. However, development in line with international standards for social insurance will likely require systemic reform. Social security experts recommend that countries should strike a balance between preventing hardship in old age, requiring people who can afford it to save for their retirement, and leaving room for individuals to choose to save even more than required. This balance takes form as a multi-pillar system based on the principle that different programs are needed to serve different objectives, specifically, redistribution, compulsory savings, and voluntary earnings replacement.

136. The social security system in Ghana could be organized around three pillars. The first pillar would be a scaled down version of the current SSNIT program and provide a minimum benefit as a social safety net for elderly and disabled individuals. To avoid redistribution to

high earners, benefits would not be earnings related, but, instead means tested and would be administered by the government or SSNIT. The second pillar would provide benefits more closely linked to earnings or contributions, which would help mitigate perception of contributions as a tax and other disincentives to work. This pillar could be managed by an agency like SSNIT, or possibly several such agencies or private companies that can compete for investment of contributions subject to prudential regulation. Indeed, development of this second pillar is in line with government policy to encourage development of collective investment instruments, such as occupational pension plans, mutual funds and unit trusts. These first two pillars would be mandatory so as to achieve the redistributive and compulsory savings objectives of social insurance, and discourage free-riding in the form of benefit manipulation and other means by which individuals effect transfers to themselves. The third pillar would build on the second pillar but operate on a voluntary basis for individuals who want to have higher benefits than provided by the compulsory pillars. This three-pillar approach spreads the risks associated with replacement of individuals' income and ensures better protection.

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V. STOCK EXCHANGE³⁷

A. Introduction

137. The incorporation of the stock exchange in Ghana in November 1990 was part of the structural reforms initiated in the mid-1980s. As in many other developing countries, the financial system in Ghana at the end of the 1980s consisted essentially of the banking sector with most banks owned by the state. The presence of a stock exchange was seen as increasing the possibilities for portfolio diversification, therefore raising financial savings and contributing to capital formation. The stock exchange was also seen as a way to accelerate the privatization program by creating a mechanism through which Ghanaian investors could participate in the ownership of large enterprises.

138. This paper describes the organization of the Ghana Stock Exchange (GSE) and explains its role in deepening the financial system.

B. Background

139. The GSE has no shareholders but is incorporated as a public company limited by guarantee.² It is governed by a council comprising representatives from the licensed dealing members, listed companies, banks, insurance companies, money market participants, and the general public.

140. The GSE has two categories of members: licensed dealing members (LDMs) and associate members. An LDM is a corporate body licensed by the stock exchange to deal with listed companies. An associate member is an individual or corporate body that has satisfied the GSE's membership requirement but is not licensed to deal in securities. There is no fixed capital requirement for LDMs, but their stated capital is expected to be at least C 100 million (about US\$40,000, as of June 1999). The firm must be licensed by the Securities Regulatory Commission and must be in possession of a certificate of specification before commencing operations. LDMs must also be approved by the GSE. Currently, 12 LDMs operate on the GSE. All of them are allowed to serve nonresidents.

141. All types of securities can be listed on the GSE. Criteria for listing include capital adequacy, profitability, years of existence, and management efficiency. All listings are included

³⁷ Prepared by Vassili Prokopenko.

² That is, the GSE is a not-for-profit organization.

in the GSE All-Share Index. There are currently 22 equities listed (see Appendix I). There are also four dollar-denominated corporate bonds.

142. Ordinary shares and corporate bonds are traded three times a week, on Mondays, Wednesdays, and Fridays, between 10:00 a.m. and 12 noon. Shares of Ashanti Goldfields are also traded over the counter after GSE trading hours, with these trades reported to the GSE at the next trading session (Box 4). Delivery and settlement are centralized but not yet automated, with a settlement period of T + 5 days. However, the GSE is setting up an automated clearing, settlement, and depository system that should reduce the settlement period to T + 3 days.

Box 4. Ashanti Goldfields Company

Ashanti Goldfields Company Ltd. (AGC) is the largest sub-Saharan African company outside of South Africa and the leading company in the Ghanaian mining industry. Ashanti used to account for 90 percent of Ghanaian production of gold, but its dominance has been eroded by other mines, which accounted for about 37 percent of Ghana's estimated gold production of approximately 53,500 kilograms in 1997. The company has 10,000 employees.

The AGC was once owned by the Ghanaian government (55 percent stake) and the U.K. conglomerate Lonrho Plc. (45 percent), but the ownership structure changed in 1994 when a portion of its shares was floated on the London and Accra stock exchanges, leaving the government with about 29 percent. In February 1996, the AGC became the first African company to be listed on the New York Stock Exchange after the Ghanaian government's decision to sell part of its shares in the company, equivalent to 6 percent of total equity, for US\$100 million to a group of international pension funds. Currently, AGC is also listed on the Australian, Toronto, and Zimbabwe stock exchanges. There are plans to further reduce government shareholding to 20 percent through the sale of a further 2 percent of equity.

There seems to be a possibility of arbitrage between AGC shares on the GSE and other stock exchanges. For example, since its listing on the Zimbabwe Stock Exchange in May 1996, those shares have traded at a discount to the prices on other stock exchanges. This was due in part to the small number of Ashanti shares on the Zimbabwean register, which made its stock relatively difficult to trade on the local stock exchange. Ashanti has about 900,000 shares quoted on the Zimbabwe exchange, out of a total 90.3 million shares issued.

143. All investors are subject to a 10 percent withholding tax on dividend income, although they are exempt until November 2005 from the tax on capital gains on securities listed.

144. Initially, nonresidents could not trade on the GSE, but the situation was substantially liberalized in 1994. Nonresident investors can now deal in securities listed on the GSE without obtaining prior permission, although there are some restrictions on foreign portfolio investors not resident in Ghana. There are no exchange controls on the remittance of original investment capital, capital gains, dividends, interest payments, returns, and other related earnings. The current limits on nonresident investor holdings (institutional or individual) are as follows: a single investor (non-Ghanaian who lives outside the country) is allowed to hold up to 10 percent of the equity of each stock issued; and foreign investors in aggregate may hold

up to a cumulative total of 74 percent of the equity in any stock issue (in special circumstances, this limit may be waived). These limits exclude trade in Ashanti Goldfields shares.

C. Overview of the Present Situation

145. Since its establishment, the GSE's performance has varied considerably (Table 17 and Figure 17). In 1993, the GSE was the sixth-best performer among emerging stock markets with a capital appreciation of 116 percent. In the following year, the GSE was the best-performing stock market among all emerging markets, as its index rose by 124 percent. Market capitalization also increased markedly owing to the flotation of Ashanti Goldfields Company and the government's sale of 20 percent of its then 55 percent stake in the company. In 1995, however, the GSE index increased by a meager 6.3 percent, in part because of the high inflation and interest rates during that period. There was progressively stronger growth over the next three years, with the GSE index increasing by 70 percent (63 percent in dollar terms) in 1998, making it the best-performing market in Africa (Table 18).

146. In terms of market capitalization, which measured about US\$1.4 billion at the end of 1998, the GSE has become one of the largest sub-Saharan stock exchanges. Ashanti Goldfields Company (AGC) is by far the most important stock on the exchange. Since its flotation in 1994, the capitalization of AGC has represented more than 70 percent of the market total on average. It thus heavily influences the key market figures for the rest of the stock market.³⁸

147. Besides the AGC, the manufacturing and brewing sectors dominate the GSE (Appendix I). A distant third is the banking sector, with most other listed companies in the insurance, mining, and oil sectors. Many of the listed companies on the GSE are Ghanaian-owned subsidiaries of multinational companies.

148. The expansion of the stock market has been driven to a large extent by privatization, as most companies on the GSE were originally state corporations. After the flotation of AGC shares in 1994, the sale of the state stake in the Social Security Bank boosted the market, as well as the flotation of part of the Ghana Commercial Bank shares that belonged to government. Pioneer Aluminum Factory and Aluworks were among other large companies privatized during 1995-98.

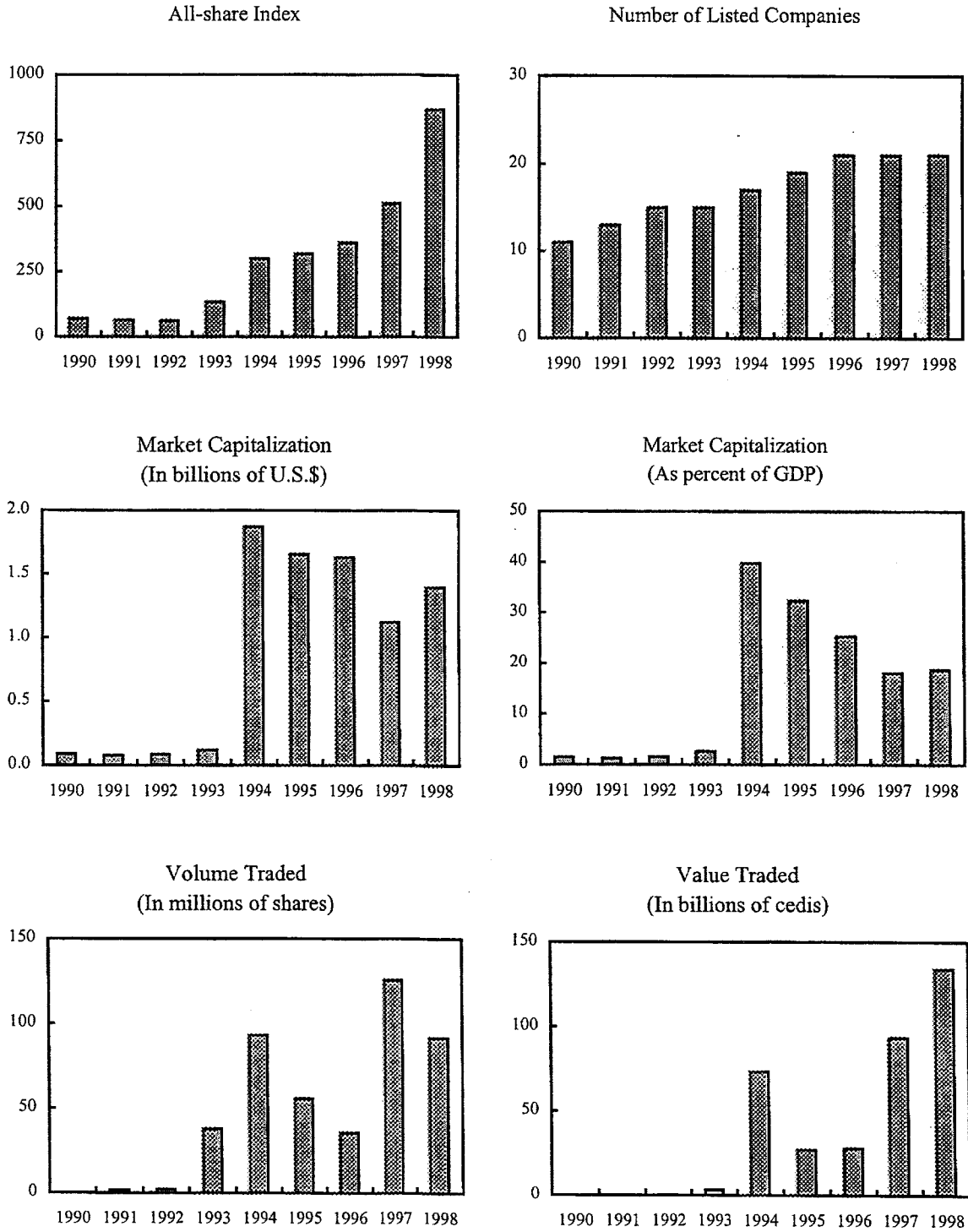
³⁸ For example, in June 1995, the GSE Index was trading at a price/earnings ratio of 20, however, excluding Ashanti, this figure dropped to 10. Similarly, the average GSE dividend yield with Ashanti was 1.02 percent but without Ashanti was 6.33 percent (AED, 1995).

Table 17. GSE Performance Statistics

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|-------|-------|-------|---------|---------|---------|---------|---------|---------|
| GSE All-Share Index | 70.3 | 64.5 | 62.2 | 132.9 | 298.1 | 317.0 | 360.8 | 511.7 | 868.4 |
| Annual percentage change | ... | -8.2 | -3.6 | 113.8 | 124.3 | 6.3 | 13.8 | 41.9 | 69.7 |
| Number of listed companies | 11.0 | 13.0 | 15.0 | 15.0 | 17.0 | 19.0 | 21.0 | 21.0 | 21.0 |
| Market capitalization | | | | | | | | | |
| In billions of cedis | 30.5 | 29.6 | 43.8 | 96.5 | 1,968.4 | 2,399.0 | 2,862.7 | 2,552.8 | 3,245.6 |
| In billions of dollars | 0.1 | 0.1 | 0.1 | 0.1 | 1.9 | 1.7 | 1.6 | 1.1 | 1.4 |
| In percent of GDP | 1.5 | 1.2 | 1.6 | 2.6 | 39.8 | 32.3 | 25.2 | 18.1 | 18.7 |
| Excluding AGC (in billions of cedis) | ... | ... | ... | ... | 206.4 | 279.0 | 453.7 | 699.8 | 1,259.6 |
| Volume traded (in million of shares) | 0.2 | 1.8 | 2.0 | 37.9 | 93.0 | 55.8 | 35.8 | 125.6 | 91.4 |
| Annual percentage change | ... | 731.8 | 11.5 | 1,759.8 | 145.2 | -40.0 | -36.0 | 251.4 | -27.2 |
| Value traded (in billion of cedis) | 0.1 | 0.1 | 0.2 | 3.2 | 73.1 | 27.1 | 27.9 | 93.4 | 134.0 |
| Annual percentage change | ... | 62.6 | 65.7 | 1,732.4 | 2,199.9 | -62.9 | 2.9 | 234.9 | 43.6 |
| Turnover ratio (in percent) | 0.2 | 0.4 | 0.4 | 3.3 | 3.7 | 1.1 | 1.0 | 3.7 | 4.1 |
| Ashanti Goldfields Company | | | | | | | | | |
| Capitalization (in billion of cedis) | ... | ... | ... | ... | 1,762.0 | 2,120.0 | 2,409.0 | 1,853.0 | 1,986.0 |
| Volume traded (in million of shares) | ... | ... | ... | ... | 1.7 | 0.3 | 0.2 | 0.1 | 0.1 |
| Value traded (in billion of cedis) | ... | ... | ... | ... | 33.6 | 7.8 | 6.5 | 1.4 | 1.0 |
| Memorandum items: | | | | | | | | | |
| Exchange rate (end of period; cedis per dollar) | 345 | 391 | 521 | 820 | 1,053 | 1,449 | 1,754 | 2,273 | 2,326 |
| Nominal GDP (in billion of cedis) | 2,032 | 2,428 | 2,803 | 3,675 | 4,950 | 7,418 | 11,339 | 14,113 | 17,357 |

Sources: IFS, IFC, and GSE.

Figure 17. Stock Exchange Indicators, 1990-1998



Sources: IFS; IFC and GSE.

Table 18. Africa: Performance of Stock Exchanges
(As of December 31, 1998)

| | Year of Establishment | Number of Listed Companies | Market Capitalization (In billions of U.S. dollars) | Capital Return in 1998 (In U.S. dollars) |
|---------------|-----------------------------|----------------------------------|---|--|
| Botswana | 1989 | 23 | 0.72 | 14.3 |
| Côte d'Ivoire | 1976 | n.a. | n.a. | 22.9 |
| Egypt | 1881 | 870 | 24.12 | -26.6 |
| Ghana | 1990 | 21 | 1.39 | 63.1 |
| Kenya | 1954 | 57 | 2.09 | -3.5 |
| Malawi | 1995 | n.a. | n.a. | -25.0 |
| Mauritius | 1989 | 32 | 1.67 | 5.8 |
| Morocco | 1929 | 53 | 15.69 | 26.4 |
| Namibia | 1992 | 40 | 0.43 | -46.6 |
| Nigeria | 1960 | 186 | 11.69 | -20.8 |
| South Africa | 1887 | n.a. | n.a. | -27.6 |
| Sudan | 1995 | n.a. | n.a. | n.a. |
| Swaziland | 1990 | 5 | 0.09 | n.a. |
| Tunisia | 1989 | 36 | 2.17 | 5.9 |
| Zambia | 1994 | 9 | 0.29 | -58.0 |
| Zimbabwe | 1896 | 70 | 0.96 | -54.8 |

Sources: IFSE and Standard Bank.

149. However, the expansion caused by privatization has not been matched by private firms seeking long-term capital from the market. The GSE's management tried to change this in 1998 by embarking on a massive media advertising campaign to educate the public on the advantages of investing; nevertheless, the results of this campaign have not been significant so far.

D. Conclusion

150. Since its establishment in 1990, the GSE has been progressively strengthening its facilities for businesses and government to raise long-term capital as well as for investors to obtain liquidity, reasonable capital safety and diversity of investments. Even though it is still a relatively young stock exchange, it is progressing faster than most of the African stock exchanges and is receiving significant attention by international media.³⁹

151. Despite some significant achievements (liberalization of exchange controls, contribution to successful privatization of enterprises, etc.) the GSE remains fairly illiquid like many other African markets. In 1998, the turnover rate was just 4 percent, the value of traded shares was up by 47 percent from the previous year, but it mainly reflected higher share prices while volume traded declined by 25 percent.

152. Finally, the GSE needs to rely more on domestic investors. The Ghanaian authorities plan to develop domestic mutual funds and unit trusts, which would reduce the volatility of the market and make it less dependant on foreign investors. A draft law on domestic mutual funds and unit trusts is expected to be put before parliament in the near future. Stable macroeconomic conditions and the creation of an adequate regulatory framework are key for the continued success of the capital market.

³⁹ It has received coverage by most of the major electronic and print media specializing in global financial news. The GSE is also on the internet, and contact can be made through e-mail.

References:

AED, 1995, "Ghana: An AED Special Report," *Africa Economic Digest*, 16: 9-32.

Dotchévi, Pascal, 1998, "Ghana : L'Envol de la Bourse d'Accra," *Jeune Afrique Economie*,
October, 272: 69-71.

Ghana Stock Exchange, 1998, *Fact Book 1998*.

Companies listed on GSE

1. ABL - Accra Brewing Ltd.
2. AGC - Ashanti Goldfields Company Ltd.
3. ALW - Aluworks
4. CFAO - French Company for West Africa
5. EIC - Enterprise Insurance Co. Ltd.
6. FML - Fan Milk Ltd.
7. GCB - Ghana Commercial Bank Ltd.
8. GGL - Guinness Ghana Ltd.
9. HFC - Home Finance Company Ltd.
10. KBL - Kumasi Brewery Ltd.
11. MGL - Metalloplastica (GH) Ltd.
12. MLC - Mechanical Lloyd Co. Ltd.
13. MOCL - Mobil Oil Ghana Ltd.
14. PAF - Pioneer Aluminum Factory Ltd.
15. PTC - Pioneer Tobacco Company Ltd.
16. PZ - Paterson Zochonis Gh. Ltd.
17. SCB - Standard Chartered Bank
18. SPPC - Super Paper Products Company Ltd.
19. SSB - Social Security Bank
20. UNIL - Unilever Ghana Ltd.
21. UTC_E - UTC Estates
22. CMLT - Camelot

Bonds

1. HFC Housebonds Series A
2. HFC Housebonds Series B
3. HFC Housebonds Series C
4. HFC Housebonds Series D

VI. GHANA'S DIVESTITURE PROGRAM: OBSTACLES AND ACHIEVEMENTS⁴⁰

A. Introduction

153. After independence, Ghana chose a state-centered approach to economic development. By the early 1980s, the public sector completely dominated production, accounting for 75 percent of formal employment. Public enterprises (PEs) were involved in almost all sectors of the economy, including mining, agriculture, finance and banking, manufacturing, trade, construction, energy, and telecommunication.⁴¹ However, most public enterprises proved to be inefficient, and political interference made them increase their employment levels to a point where productivity was extremely low. As a result, in 1983, the public enterprises had become a major burden on government finances.

154. The Economic Recovery Program (ERP), introduced in 1983 to reverse the economic decline of the previous decade, recognized the need for a comprehensive reform of the public enterprise sector⁴². The reform program included, among others, overall policy changes (e.g., price liberalization) to ensure commercial operation of public enterprises, reduction and retraining of the workforce to improve efficiency, restoration of financial solvency and discipline through clearance of cross-debts and arrears, and rationalization of the PE sector through privatization and mergers. At the initial stage, responsibility for implementing the divestiture program—together with other reforms in the PE sector—fell to the State Enterprise Commission (SEC). However, lack of commitment to carry out these reforms, together with doubts about the benefits of large-scale privatization, resulted in negligible progress⁴³. That said, it was also true that an overall policy environment conducive to private-sector-led development had yet to be fully established in the late 1980s. As a result, there were still about 350 public enterprises, and the PE sector continued to be a burden on government resources.⁴⁴

⁴⁰Prepared by Girma Begashaw.

⁴¹See Friedrich Ebert Foundation (1994), p. 53.

⁴²During 1966–72, there were some attempts to introduce market-oriented reforms, and to reduce state intervention in the economy through privatization. These attempts largely failed owing to poor execution and lack of commitment.

⁴³See Friedrich Ebert Foundation (1994), pp. 9-17.

⁴⁴During 1985-89, net outflow from the Government to 14 core public enterprises—which accounted for 60 percent of employment, 72 percent of sales, and 67 percent of value added

(continued...)

B. The Divestiture Implementation Committee and the Early Efforts

155. In 1988, a major new effort to privatize public enterprises began with the establishment of the Divestiture Implementation Committee (DIC), which took over the divestiture responsibility from the SEC. Although DIC's responsibility would only be formalized in 1993—when the Divestiture of State Interest Law established the legal framework for divestiture—it immediately undertook responsibilities for communicating government policies and consulting interested bodies on divestiture, formulating criteria for selection of enterprises to be divested, developing and implementing divestiture procedures, and evaluating the effects of all divestitures.⁴⁵ The SEC became mainly responsible for monitoring performance of public enterprises and, more generally, advising government on restructuring, rehabilitation, and divestiture of public enterprises.

156. The 1988 divestiture program was different from previous attempts because it was formulated concurrently with efforts to liberalize the Ghanaian economy to attract private sector investment. Thus, it was intended to: (a) reduce or eliminate the financial burden of the PE sector on government finances; (b) improve the overall efficiency of the Ghanaian economy; (c) downsize the public sector; and (d) refocus the role of the state in the economy.

Performance during 1989-1992

157. During this period, only 59 public enterprises were divested—out of more than 300 public enterprises operating in all sectors of the economy—generating proceeds amounting to C 21.7 billion (Table 19). As a substantial number of the divested public enterprises did not have a viable business, often having negative net worth, 26 of them were liquidated (21 of them in 1990 alone), and produced no proceeds. Aside from these liquidations, the overall pace of divestiture during this period was very slow. Factors which contributed to few sales included: (a) weaknesses in the DIC, including the inability to process enterprises in a reasonable time period; (b) lack of up-to-date financial and other relevant information on the public enterprises being offered for sale; (c) lack of transparency of the divestiture process itself; (d) slow process of asset valuation by the Land Valuation Board; (e) indecision on how to deal with liabilities of the enterprises, particularly, severance payments; and (e) lack of coordination among the DIC and other government bodies involved in the

by the PE sector—averaged about 11 percent of total government expenditures; in 1989 it had reached 17 percent. For details see IDA (1991) and IMF (1996).

⁴⁵See Opoku (1999), pp. 4-5.

Table 19. Ghana: Divestiture of State-Owned Enterprises, 1989-September 1999 1/
(In millions, unless otherwise specified)

| | 1989 | 1990 | 1991 | 1992 | 1989-92 | 1993 | 1994-96 | 1997-98 | 1999 2/ | 1993-98 | 1993-99 2/ | 1998-99 2/ |
|---|------|-------|-------|--------|---------|-------|---------|---------|---------|---------|------------|------------|
| Number of state-owned enterprises divested | | | | | | | | | | | | |
| Joint ventures | 0 | 0 | 1 | 2 | 3 | 0 | 10 | 2 | 0 | 12 | 12 | 15 |
| Lease | 0 | 2 | 0 | 0 | 2 | 0 | 2 | 1 | 0 | 3 | 3 | 5 |
| Liquidation | 0 | 21 | 3 | 2 | 26 | 3 | 7 | 2 | 0 | 12 | 12 | 38 |
| Outright sales | 2 | 1 | 5 | 3 | 11 | 4 | 45 | 19 | 9 | 68 | 77 | 88 |
| Sale of shares | 0 | 8 | 3 | 6 | 17 | 3 | 15 | 9 | 2 | 27 | 29 | 46 |
| Divestiture proceeds | | | | | | | | | | | | |
| Cedis | 28 | 488 | 6,989 | 4,048 | 11,554 | 2,684 | 137,980 | 34,466 | 8,265 | 175,131 | 183,396 | 194,950 |
| US dollars | 0.0 | 3.6 | 2.1 | 9.1 | 14.8 | 0.8 | 522.1 | 48.7 | 39.0 | 571.6 | 610.6 | 625.4 |
| UK pounds | 0.0 | 3.3 | 0.1 | 0.0 | 3.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| German Mark | 0.0 | 0.0 | 0.0 | 8.1 | 8.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| French francs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 21.0 | 0.0 | 0.0 | 21.0 | 21.0 | 21.0 |
| Total (in millions of cedis) 3/ | 28 | 3,561 | 7,853 | 10,301 | 21,743 | 3,223 | 756,383 | 140,982 | 104,502 | 900,787 | 1,005,289 | 1,027,032 |
| Divestiture proceeds collected | | | | | | | | | | | | |
| Cedis | 11 | 488 | 6,922 | 4,048 | 11,469 | 2,684 | 131,565 | 22,155 | 5,815 | 156,404 | 162,220 | 173,688 |
| U.S. dollars | 0.0 | 3.6 | 2.1 | 7.6 | 13.3 | 0.6 | 501.9 | 32.1 | 1.5 | 534.6 | 536.1 | 549.4 |
| UK pounds | 0.0 | 3.3 | 0.1 | 0.0 | 3.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| German Mark | 0.0 | 0.0 | 0.0 | 8.1 | 8.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| French francs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 21.0 | 0.0 | 0.0 | 21.0 | 21.0 | 21.0 |
| Divestiture proceeds outstanding 4/ | | | | | | | | | | | | |
| Cedis | 18 | 0 | 68 | 0 | 85 | 0 | 6,416 | 12,311 | 2,450 | 18,726 | 21,176 | 21,262 |
| U.S. dollars | 0.0 | 0.0 | 0.0 | 1.5 | 1.5 | 0.3 | 20.2 | 16.6 | 37.5 | 37.1 | 74.5 | 76.0 |
| Total | | | | | | | | | | | | |
| In millions of cedis 5/ | 18 | 0 | 68 | 4,005 | 4,090 | 668 | 60,430 | 56,553 | 102,495 | 117,650 | 220,145 | 224,235 |
| In percent of end-of-period GDP | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.0 | 0.6 | 0.3 | 0.5 | 0.7 | 1.1 | 1.1 |

Source: Ghanaian authorities; and Fund staff estimates and calculations.

1/ Including those enterprises divested through the DJC and outside the DJC framework.

2/ 1999: January to September.

3/ Calculated using average exchange rate for the period.

4/ As at end-September 1999.

5/ The values in foreign currency are valued at end-September 1999 exchange rate.

divestiture⁴⁶. Finally, the slow progress in divestiture also sometimes reflected strong resistance from workers and management of the enterprises being sold who were striving to increase their share of benefits from the sale.

C. Recent Divestiture Experience, 1993–1999

158. In 1992, Ghana's macroeconomic performance suffered a major setback when pre-election civil unrest forced the government to grant large wage increases as well as incur other expenditures aimed at obtaining the support of key pressure groups. The result was a sharp deterioration in the fiscal position of the government and an acceleration of inflation. Faced with this situation, the government had to find a way to adjust the fiscal position quickly, and yet was not prepared to cut expenditures by as much as would be needed to reverse the fiscal deterioration. As a compromise, the government chose to tackle the fiscal problem largely through flotation on the stock exchange of its shares in some of its most profitable enterprises (see below).

159. The divestiture procedures used by DIC are summarized in Box 5.

Procedural changes

160. To regain momentum and also enhance the contribution of divestiture to economic efficiency, an accelerated divestiture phase was envisaged, in support of which IDA approved in July 1995 a Private Sector Adjustment Credit (PSAC) amounting to SDR46.9 million, complemented by technical assistance from the UK's Department for International Development (DFID)⁴⁷. This phase introduced several changes designed to improve the efficiency of the DIC⁴⁸.

161. First, the DIC, which previously consisted of only government officials, was modified in early 1995 to include two members from the private sector and a representative of trade unions, a change that was expected to increase transparency and involve other stakeholders in the divestiture process. The DIC also established a communications office to educate the public at large on the merits of divestiture and to solicit inputs into the divestiture program. It also agreed to meet more frequently than once a month, its schedule before 1995.

⁴⁶See SDC Investments Ltd. (1995), pp. 11-14.

⁴⁷IDA (1998).

⁴⁸See SDC Investments Ltd. (1995), pp. 12-14, and IDA (1998), p. 3.

Box 5. Divestiture Procedures

The list of enterprises to be divested was prepared by the government following consultations among interested government agencies, including the SEC, line ministries, and the DIC itself, and then provided to the DIC. The **selection criteria** included the need to minimize economic disruption, impact on the economy, and maximization of future tax revenues. As these criteria were not objectively defined and the process lacked transparency, the choice of enterprises for divestiture was somewhat arbitrary. Following selection of public enterprises to be divested, the process of divestiture would begin with regular meetings (once a month) of the DIC—to decide on such issues as the amount of government shares to be divested and the modality of divestiture to be employed.

The choice of the **modality of divestiture** had to balance the desire for a speedy restart of the enterprise through new management, investment, and better know-how, against a preference toward majority ownership by nationals, and the need to prevent management and workers from forestalling the privatization process. In the case of large enterprises, the mode of divestiture involved the breaking of the enterprises into smaller units for outright sales to nationals, or finding a strategic investor who would take a significant share and management of the enterprise while floating the remaining shares in the Ghana Stock Exchange.

The next step was the preparation by the DIC of a dossier, known as **information memorandum**, to be presented to potential buyers. The dossier would contain updated financial information, value of assets, and other relevant information on the public enterprises. Then, based on the information memorandum, selected public enterprises would be offered for sale through advertisements in Ghanaian newspapers and, for larger enterprises, also in international publications.

Potential bidders would be allowed to undertake due diligence—look closely into assets, operations, and records of the enterprise before submitting bids. A team of experts from the DIC, line ministries, and other government bodies would undertake the **evaluation of investors' bids**. The selection of an investor would be based on **prices** (prices offered, payment options, and financing of bid) and on **investors' qualifications** (business plan, future investment, and employment). Under certain circumstances, for example, in the event of equal bids in price terms, Ghanaian investors were given preference. Negotiations with the selected investor would follow on purchase and sale agreement, including on investor's qualifications, offered price and timing of payments. The sale of the enterprise would be completed after approvals, first from the DIC and then from the President's Office, were obtained and agreement was signed with the investor.

Source: DIC and Opoku (1999).

162. Second, to improve its efficiency and accelerate the pace of divestiture, the DIC began employing suitable private consultants for the preparation of information memoranda required to offer public enterprises for sale. A new divestiture procedures manual was introduced, and both the DIC and the private sector consultants were required to use the same standard procedures to divest enterprises.

163. Finally, the DIC set for the first time explicit targets for divestiture. Under the IDA PSAC approved in 1995, a list of 114 public enterprises were specified, of which 46 medium-sized and 64 small-sized enterprises were to be divested and 4 large and strategic ones were to be prepared for divestiture. The latter were Ghana Telecom, State Insurance Corporation, State Housing Corporation, and Mim Timber. This list was later expanded to include a total of

149 enterprises from which divestiture targets of 34 small, 14 medium and the 4 large and strategic enterprises were set by the DIC for the period September 1995-October 1997.

Overview of performance

164. Bavon (1998) shows using pooled data from 32 Ghanaian firms over a ten-year period (1986-95) that the financial performance of private firms both in terms of return on assets and return on sales is stronger than in state-owned than in private enterprises, although other factors also play a role in explaining financial performance.

165. The pace of divestiture accelerated during 1994-96 when 79 public enterprises valued at C 756.6 billion were divested (Table 19, Figure 18, and Figure 19). The divestiture included sales of the Government's interests in Ashanti Goldfields (US\$462.4 million), state-owned banks (US\$65.2 million), a strategic stake in Ghana Telecom (US\$38 million), and other important enterprises (Table 20)⁴⁹. However, from 1997 to September 1999, the pace of divestiture lost momentum and only 44 enterprises valued at C 245.4 billion were divested.

166. Over the period 1993-September 1999, a total of about 133 enterprises were divested, including manufacturing enterprises, such as textiles and matches, farms, real estate units (housing and buildings), hotels, and department stores (Table 19). Of the 133 enterprises, 29 were divested through sale of shares, 77 through outright sale, 12 were liquidated, and 12 were divested through joint ventures. Large enterprises such as Ghana National Trading Corporation (GNTC), State Fishing Corporation (SFC) and State Hotels Corporation were unbundled into smaller units so that Ghanaian investors could have a better chance of competing in their acquisition.

167. Statistics from the DIC indicate that by end-1998 local entrepreneurs had bought about 80 percent of the divested public enterprises. An interesting finding in privatization processes in Africa is that whenever nationals purchase a public enterprise they are more likely to buy it on credit than on cash basis compared to foreign buyers. Also, nationals are more likely to default or request delays in payments agreed when purchasing the enterprise. The privatization process in Ghana is no exception to this rule.

⁴⁹Included in these were Tema Food Complex Corporation (for US\$14 million); Ghana Oil Palm Development Corporation (US\$7 million); GNTC Bottling (US\$7 million); Ghana National Manganese Company (US\$4 million) and; Ghana Rubber Estates Ltd. (French francs 21 million).

Figure 18. Ghana: Number of State Owned Enterprises, 1992-99

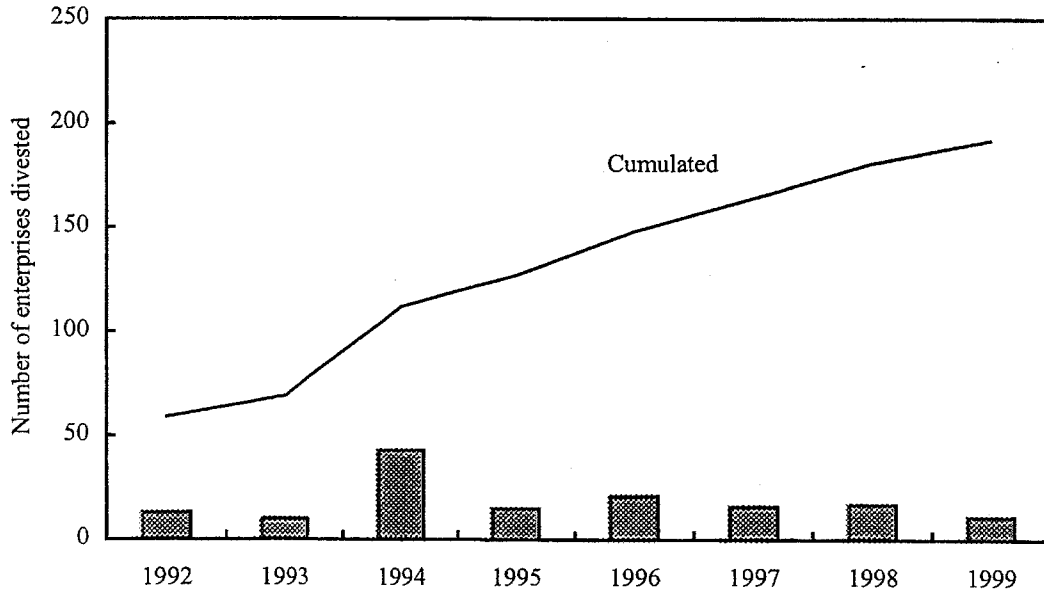
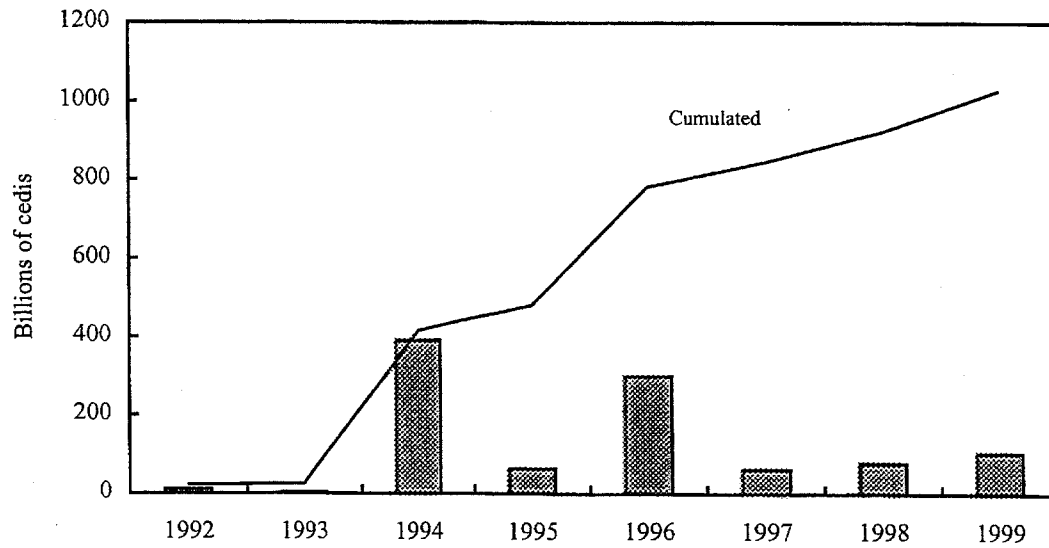


Figure 19. Ghana: Divestiture Proceeds, 1992-99



Source: DIC

Table 20. Ghana: Divestiture of State-Owned Enterprises Outside the DIC, 1989-September 1999

| | Date of privatization | Sale of shares | | Total 1/ |
|----------------------------|-----------------------|----------------|----------|----------|
| | | US\$ 1/ | Cedis 2/ | |
| Ashanti Goldfields Company | 1994 | 293.75 | 60,900 | 357.40 |
| | 1996 | 105.00 | 0 | 105.00 |
| Social Security Bank | 1995 | 23.64 | 12,021 | 33.65 |
| Merchant Bank | 1995 | 6.28 | 10,500 | 15.03 |
| Ghana Commercial Bank | 1996 | 0.00 | 32,796 | 20.03 |
| Ghana Telecom | 1996 | 38.00 | 0 | 38.00 |
| Total | 1994-96 | 466.67 | 116,217 | 569.12 |

Source: Divestiture Implementation Committee.

1/ In millions of U.S. dollars.

2/ In millions of cedis.

Obstacles

168. The initial acceleration of divestiture (during 1994–96) could not be sustained in later years for several reasons. The operation of some public enterprises remained a source of concern. Their contribution to economic growth has remained consistently below their potential; at times, they have imposed a significant burden on the government. The checkered history of GNPC is an example of how the privatization process can be postponed and ultimately sidetracked, despite clear evidence that moving decisively with it would have been in the national interest (Box 6).

169. The emphasis of the divestiture program seems to have been on small and medium-sized enterprises since many large (and even some medium-sized) public enterprises have yet to be divested.⁵¹ The targets set under the PSAC (see above) were not achieved as originally envisaged, as only about 50 enterprises had been divested by early 1998, which was a significant delay. Moreover, out of the target set for large and strategic enterprises, only Ghana Telecom was divested by then⁵².

170. Moreover, as privatization was delayed, some public enterprises' net worth became increasingly negative. Also, even though several public enterprises have been divested, a substantial portion of the proceeds has **yet to be collected** even for those enterprises divested earlier. From total proceeds of C 1,027 billion for 1989–September 1999, about one-quarter (C 224.2 billion or 1.12 percent of GDP) remained uncollected at end-September 1999 (Table 19).

171. An important factor in the slow progress of the divestiture program continued to be the DIC's **lack of dynamism** in preparing public enterprises for divestiture—in particular the large and so-called “strategic” enterprises—and in selecting consultants for outsourcing. The **outsourcing** of divestiture itself did not help achieve its stated objectives of accelerating divestiture, increasing transparency, helping the DIC play more of a supervisory role, and increasing revenue from the sale of public enterprises.⁵³ This was largely attributed to inexperience in divestiture by local private consultants, lack of transparency in their selection,

⁵¹Included among these are Ghana Airways, Electricity Company of Ghana, Tema Oil Refinery, Produce Buying Company, Ghana Commercial Bank, Ghana Railways Corporation, State Shipping Company, National Investment Bank, and State Insurance Company of Ghana.

⁵²See IDA (1998), p. 6.

⁵³IMAS Ltd. (1999).

Box 6. Ghana National Petroleum Corporation (GNPC)

The GNPC was created in 1983 and charged with the exploration and procurement of crude oil. To finance its activities, it was also given the monopoly on the importation of crude oil and, through an arrangement with the Tema Oil Refinery, it became the sole wholesale supplier of petroleum products to the oil marketing companies operating in Ghana. It branched out into other activities, creating a number of subsidiaries in areas as diverse as salt production and gold mining. Despite this broad range of activities and privileged arrangements, GNPC seldom made profits. It financed a number of long-term projects through successive extensions in maturities of oil-import credits extended or guaranteed by the Bank of Ghana. These operations resulted in high interest costs and exchange losses. In 1994, faced with US\$15 million in additional losses from investments in financial derivatives, GNPC fell in arrears on credits provided by the Bank of Ghana causing a major monetary expansion that seriously undermined the implementation of monetary policy. The total amount of its losses at that time was estimated at around C 200 billion, or about 4 percent of GDP.

These problems prompted the government to take action in 1995 to correct this situation. An audit of GNPC accounts was carried out, and GNPC's access to new Bank of Ghana credits was eliminated. A decision was also made to sell GNPC's nonessential assets and to use the receipts to repay the Bank of Ghana. GNPC itself was placed in the list of enterprises to be privatized. Finally, from April 1996 onward, GNPC's monopoly on importation of crude oil was removed, being replaced by a system of open bidding for oil procurement contracts. GNPC was then directed to focus primarily on hydrocarbon and energy-related activities.

Despite these decisions, there has been no serious efforts to privatize GNPC and the company is no longer in the list of companies to be privatized by the government. The leasing of its drilling rig—and income from nonessential assets and financial investments—allowed it to begin repaying its debt to Bank of Ghana in August 1997. The sale of its non-financial assets, finally achieved in March 1998, allowed it to complete the repayment of its debt to the Bank of Ghana in April 1998. In 1999, the GNPC continues to operate as a public enterprise representing Ghanaian interests in the West African Gas Pipeline, while it continues its efforts to develop a natural gas-fired power plant financed primarily by US Export-Import Bank loans and utilizing natural gas from the Tano field. That project has however faced a number of difficulties including refusal by the government to offer the necessary guarantees as the loan is nonconcessional and failure to find a private sector partner willing to take over a significant share of the project risks. In 1996, the World Bank concluded that, while viable at the margin, the project was not the best option available to Ghana. In January 1999, GNPC's losses in hedging operations amounting to about US\$40.2 million surfaced, plunging GNPC into a new controversy.

and the inadequate preparation for privatization of some of the enterprises⁵⁴. Moreover, the divestiture manual, which was to outline agreed norms and standards for divestiture to be used by both the DIC and the private consultants, came out only in January 1997, which was a significant delay. Also, **interference** by officials and interested parties, **indecision and unwillingness** to divest certain public enterprises for political and “strategic” reasons, and the

⁵⁴Public enterprises passed on by the SEC to DIC for divestiture often could not be sold without difficulties. For example, some enterprises did not have titles to the land they occupied, while others did not have audited financial records for some years.

inability of Ghanaian investors to mobilize resources for investment played a role in the slow progress of divestiture. Decisions were often postponed for various reasons, including the absence from the country of key DIC members.

172. In addition, **inadequate transparency, and a cumbersome legal and regulatory environment**, of which the difficulty in transferring land titles has been an important example, beset the whole divestiture process. The **divestiture process** itself, which required approval of final sale by the President's Office, proved to be too drawn out, on occasion giving rise to unwarranted consultations with "interested" parties and extending the period required for final approval of sale.

173. Finally, the **democratization** of the Ghanaian society beginning in the early 1990s has become an important factor in divestiture as it calls for more transparency in the process. Parliament has shown interest in the divestiture process by requiring more information on the sale of key public enterprises and, in some cases, has been vocal in opposing the divestiture of the so-called "strategic" enterprises. Workers and management of certain public enterprises have at times voiced their opposition to sales of enterprises to outside investors and suggested worker-management buyouts. A case in point was Ghana Oil (GOIL) whose divestiture was protracted owing to opposition by a workers-management group. The divestiture process of the Produce Buying Company (PBC) has been delayed by several years to accommodate various stakeholders. The divestiture of Tema Oil Refinery (TOR) has also been postponed in part because of opposition or reluctance to divest this strategic enterprise (Box 7).

Achievements

174. It would be wrong, however, to focus solely on the difficulties faced by the divestiture program, without according due regard to the achievements of the program. First, the sale of public enterprises has generated proceeds for the Ghanaian National Treasury, and the proceeds have been important in financing the fiscal deficits since 1993. More importantly, divested enterprises have generally achieved a vigorous expansion in production, owing to investment in new technology and increased capacity utilization, as well as improved employee's skills⁵⁵. As a result, both the tax base and the level of employment have risen in the post-divestiture period. Also, consumers have benefited from increased supply of quality goods and competitive pricing from the divested public enterprises. The divestiture program has also contributed to the development of the local capital market, providing Ghanaian investors an opportunity to make small equity investments⁵⁶.

⁵⁵Technology Consultancy Centre (1999).

⁵⁶Key companies floated in the Ghana Stock Exchange included: Ashanti Goldfields Company, Aluworks Company, Ghana Aluminium Company, Ghana Commercial Bank, and Social Security Bank. See also Chapter V.

Box 7. Divestiture of Strategic Companies

Ghana Oil Company (GOIL). The attempt to sell GOIL was delayed in 1998 because of the need to enhance transparency in the choice of the investment advisor. Following the offer for sale of GOIL in October 1998, some members of parliament voiced concern regarding sale of this "strategic" enterprise. A worker-management group was put together to make a bid for the company and to oppose the sale of a controlling interest in the company to a single investor. In early 1999, bids from Total Ghana Ltd., Engen of South Africa, and from the GOIL Buyout Consortium representing a workers-management group were evaluated and a recommendation was made by DIC to the President's Office. The President's Office has asked DIC to make sure that proper transparency procedures had been followed before it would give final clearance for the sale.

Produce Buying Company (PBC). Privatization of the PBC has been opposed at one time or another by members of parliament, government officials, including cabinet members, farmers, and the staff of PBC and Cocobod. Nevertheless, its sale is a key element of the medium-term cocoa strategy approved by cabinet after a lengthy process of stakeholder consultation. The sale of the PBC was first decided in 1996. It was then delayed pending the formulation of a medium-term cocoa strategy. A proposal to divide PBC into three companies was then floated, but was discarded in 1998, as it was felt that it could result in lengthy discussions regarding the division of the companies assets, which could delay the whole process. A proposal to sell PBC to a strategic investor was also blocked in 1998 as this mode of divestiture was seen as favoring large foreign investors. Instead, the government decided to float 50 percent of PBC shares in the stock exchange to allow wider shareholder participation by Ghanaians. Of the remaining shares, 20 percent will be given to farmer groups, 5 percent to PBC employees, and the government will retain the other 25 percent. The sale is expected to take place before end-1999. To ensure a level playing field among the companies engaged in domestic cocoa marketing, PBC was stripped of some Cocobod's assets that it used freely in the past. Assets such as warehouses have been made available to all licensed buying companies on an equal basis.

Tema Oil Refinery (TOR). The divestiture of TOR has been delayed partly to rehabilitate the refinery and to accommodate opposition to its sale by several groups, including members of parliament and government officials, because of its "strategic" nature. Following the decision to divest TOR, and its valuation by an investment advisor in 1998, it was decided that the divestiture of the TOR be delayed while the enterprise was being financially restructured. The restructuring of the company resulted in two general-manager positions being created to oversee petroleum trading and refinery activities, respectively. It became clear from the analysis carried out during the financial restructuring that the main profit center of TOR is its trading activities and that the government should search to sell the company to a strategic investor with expertise in petroleum trading. The government has committed itself to offer TOR for sale by end-1999.

175. Moreover, the divestiture program has signaled a stronger commitment of the government to private-sector led development by attracting domestic and foreign private capital, technology, and managerial skills. It has also given the impetus to other government efforts to create an environment that is supportive of private sector activities, a strategy that was reiterated in the context of the Ghana Vision 2020. These efforts included the Private Sector Advisory Group (PSAG) established in 1991 to enhance dialogue between the public

and private sectors; the enactment of a liberal investment code and the establishment of the Ghana Investment Promotion Center (GIPC) in 1994.⁵⁷ The 1995 "Free Zone" Act designed to attract foreign direct investment in export-oriented activities and the Statutory Corporations Act aimed to facilitate the conversion of public corporations into companies ready for privatization.

176. There are many examples of divested public enterprises that have turned around their desperate situation, which existed before divestiture. Following divestiture new owners often invested in new equipment, increasing employment and production.

- **Ashanti Goldfields Company (AGC).** Following its privatization, AGC has been able to tap international capital markets for investment in new equipment and technology and to expand its operation in Ghana as well as in other countries. AGC is listed not only on the Ghana Stock Exchange, but also on other stock exchanges, including those of New York, London, Toronto, and Zimbabwe. It currently has operations in Democratic Republic of the Congo, Guinea, Tanzania, and Zimbabwe. As a result of investment in new technology, AGC's gold production rose from 1.17 million ounces in 1997 to 1.57 million in 1998, and its cost of production declined from US\$254 per ounce to US\$217 during the same period.
- **Golden Tulip Hotel.** Formerly known as the Continental Hotel, it was operating in poor conditions, having difficulties even in paying wages, which were in arrears. Following divestiture, the hotel was transformed through new investment, staff training, and additional employment. Total employment rose from the pre-divestiture level of 116 to more than 350 people. As a result, its capacity to accommodate guests rose—as number of rooms also increased from 130 to 218—and the quality of services improved dramatically.
- **Tema Steel Company.** This company, formerly known as GIHOC STEEL, had practically ceased operations before divestiture. After it was divested in 1991, new owners rehabilitated the company, and production soared to its current level of 21,500 tons a year from its pre-divestiture level of 4,500 tons a year because of increased productivity. Employment rose from the pre-divestiture level of 130 people to almost 600 by 1998.

⁵⁷From September 1994 to end March 1995, the GIPC registered 834 projects, whose total value was estimated at US\$1.3 billion. Out of the foreign investment of US\$1.0 billion, one-third was in the form of direct investment and the remaining two-thirds loans. About 77 percent of these projects have been implemented creating 51,000 jobs, of which 48,245 jobs were filled by Ghanaians and 2,973 by expatriates. The remaining 15 percent of the projects were being evaluated while 8 percent were abandoned. For details, see de Dianous (1999).

- **West African Mills Company.** New owners installed modern equipment—by investing more than DM 30 million after taking over the company—and employed more workers to boost production. Employment rose from the pre-divestiture level of 170 to 450. Production of cocoa butter more than doubled and processing of cocoa beans rose by more than five times its pre-divestiture level of 10,000 metric tons.

D. Summary and Conclusions

177. After implementation of a divestiture program for the last ten years, several medium- and large-scale public enterprises remain state-owned. A further delay in the divestiture of these enterprises, in particular those with weak financial situation, would not only prevent the efficiency gains expected from divestiture, but could also make the divestiture process more costly for the government. In particular, the opportunity cost of delaying divestiture in terms of lost tax revenue, employment and production could be substantial. The Ghana Vision 2020 strategy requires fast and sustainable economic growth to allow the country to make inroads in poverty alleviation. Divestiture is a key element of this strategy. Therefore, the government will need to find ways to accelerate the divestiture process and take it to its conclusion in the next three to five years.

178. Several measures need to be implemented in order to regain the momentum of divestiture, including the need to enhance transparency, strengthen the DIC structure, and change its divestiture strategy. **First**, impact studies have noted the lack of transparency and effective participation by stakeholders as major impediments to progress in divestiture⁵⁸. Accordingly, the timely availability of information on divestiture, the involvement of various stakeholders at an early stage, and the conduct of the bidding process with full knowledge of the stakeholders and the public at large would go a long way to enhance transparency and accountability. This approach would also help expedite the divestiture process by preempting potential questions and opposition to divestiture. The government should also make every effort to publicize the good performance of divested enterprises in the post-divestiture period.

179. **Second**, the weakness in the administration of the divestiture program needs to be corrected⁵⁹. To enhance the independence of the DIC and to expedite decisions, the government may want to consider changes in the composition of the Committee to increase representation of the private sector and other interested, but neutral, bodies. Moreover, the DIC Secretariat may have to be restructured to resolve weaknesses in its functioning that have

⁵⁸Integrated Solutions Ltd. (1991), IMAS Ltd. (1995), and SDC Investments Ltd. (1999).

⁵⁹IMAS (1999).

impeded information flow and decision-making⁶⁰. In particular, there is an urgent need to clearly define and coordinate activities of the Secretariat to improve decision making even during absence of its Executive Secretary.

180. **Third**, the strategy currently followed to prepare enterprises for divestiture may have to be reconsidered. The preparation of enterprises through, for example financial restructuring or infusion of new investment—which in a number of cases has been the source of long delays—should be avoided in most cases as it could lead to a substantial financial loss for the government when the enterprise is eventually divested. Such a loss could materialize in a situation where the new investments or restructuring may not fit the interests of new owners, who would have preferred a different approach to correcting the enterprise deficiencies.

⁶⁰The current structure of the DIC does not provide for a Deputy Executive Secretary who could take a decision in the absence of the Executive Secretary. Also, all senior staff of the DIC reports to the Executive Secretary. This structure does not lend itself to a smooth flow of information and decision, in particular during the absence of the Executive Secretary.

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VII. RURAL FINANCE IN GHANA⁶¹

A. Introduction

181. The economy of Ghana like those of many other developing countries is rural-based and strongly oriented towards the production of primary commodities. The agricultural sector employs about two-thirds of the total labor force in the country and contributes about 40 percent of GDP. The small but growing industrial sector also depends on agriculture as a source of important raw materials. The overall growth of economy is therefore largely determined by growth in agricultural sector, which is also crucial for poverty reduction.

182. The Ghanaian agriculture is well diversified and offers considerable potential for growth through intensification and productivity increases. The agricultural sector is dominated to a large extent by small-scale farmers employing traditional methods. Large-scale farming contributes only about 5 percent of total food production. There is also very little irrigated farming. Yields of most crops grown by smallholders can be tripled with currently available technology and with access to financial resources. Even relatively simple improvements in crop husbandry would allow substantial productivity gains, but these often require some form of credit to poor segments of the population. There is scope for sustainable expansion of tree crops in the forest and transition zones, and of cereals, cotton, tobacco and vegetables in the transition and savanna zones. Expansion of irrigated agriculture is feasible, and in the livestock subsector, significant productivity gains can be achieved with relatively modest investments in animal health and improved stocks.

183. While rapid agricultural growth is critical to future poverty reduction, the missing link has been the lack of efficient financial services in many communities, making it more difficult for farmers to adopt new technologies, invest in new products, or process production on-farm. Since agricultural credit is a major factor of sustainable agricultural growth, rural financial institutions play a very important role.

184. This chapter reviews the performance of the rural financial sector in Ghana and discusses how it can better contribute to the success of poverty alleviation and economic growth. Section B provides a brief history of the evolution of rural finance in Ghana, covering, in particular, the recent sector reforms. Section C deals with constraints to the provision of financial services to the rural sector. Section D describes the next steps that government and development partners intend to take to foster the development of rural finance in Ghana. Section E summarizes the main conclusions of the chapter.

⁶¹ Prepared by Rudolph Polson (World Bank), Vassili Prokopenko, and P erin Saint-Ange (IFAD).

B. Evolution of Rural Finance in Ghana

Overview

185. In the first half of this century, Ghana's rural areas were generally denied access to banking services. Almost all banking activities were concentrated in the cities, and an average rural Ghanaian businessman was usually unable to satisfy the British⁶² banking criteria for credit: he was considered a poor credit risk. Formal agricultural credit started in October 1946, when the Gold Coast Co-operative Bank was established; however this bank went into liquidation after fifteen years of operation. Its lending function was transferred to the United Ghana Farmers' Co-operative Council (UGFCC), which became the sole marketing agency for cocoa and other crops in 1961. Loans given out by the UGFCC were made in-kind through the provision of insecticides, empty cocoa sacks, fertilizers, and even tractor hiring services. These loans were deducted at source after the farmer had harvested his cocoa. In 1966, the UGFCC was also disbanded because of mismanagement of funds. The lending to the agricultural sector was then transferred to the newly created Agricultural Development Bank. A further attempt to promote formal rural finance was the establishment of rural banks since the mid-1970s.

186. Currently, Ghana's financial sector is dominated by the formal banking system, which accounts for over 80 percent of the total financial assets. The country's banking and financial institutions consist of the Bank of Ghana (BOG), which is the central bank, 17 deposit money banks (DMBs) including the Agricultural Development Bank, and 132 rural/community unit banks. The DMBs had a total of 315 branches in March 1998. However, this branch network was biased in favor of the urbanized southern regions. Greater Accra alone accounted for 30 percent of the total number of bank branches, while the three northern regions (Northern, Upper West and Upper East) together had just 9 percent of the total branches. Box 8 highlights this point by describing the limited rural financial intermediation in Upper East Region.

187. Credit extension by DMBs is primarily focused on manufacturing and commerce, with agriculture in third place in 1998.⁶³ The Agricultural Development Bank (ADB) is the only DMB with a strong emphasis on the agricultural sector, which accounts for 70 percent of its loan portfolio.

⁶² Out of the four banks, operating in Ghana before the independence, two British-owned banks controlled almost all commercial banking business (Standard Chartered Bank and Barclays Bank Ghana). Their customers were mainly the foreign trading, mining and timber companies.

⁶³ See "Ghana: Statistical Appendix," SM/99/269; 11/4/99, Table 48.

Box 8. Rural Financial Intermediation in Upper East Region (UER)

Six banks, viz., the Ghana Commercial Bank (GCB), the Standard Chartered Bank, the National Investment Bank, the Social Security Bank, the Ghana Cooperative Bank and the Agricultural Development Bank (ADB), operate in UER. Out of the six DMBs, only the GCB, Ghana's largest commercial bank, and ADB undertake rural microfinance and have participated in the implementation of IFAD funded activities. ADB operates in UER through a branch at Bolgatanga and a farm loan office at Bawku. The opening of more farm loan offices to improve the bank's network in UER is under consideration by ADB management. GCB participated in the implementation of IFAD-supported group credit activities through one of its three branches in UER. With the experience gained in handling microcredit, GCB is planning microcredit activities in all its three branches in UER, including Bolgatanga in Bolgatanga district, Bawku in Bawku East district and Navrongo in Kassena-Nankana district.

The participation in micro-credit delivery under the IFAD project has helped both GCB and ADB to build up their loan portfolio, and the profitability of their branch units. As of October 31, 1998, almost 50 percent of the total outstanding loans and advances of the participating branches in UER of the two banks consisted of group credit disbursed under the IFAD project.

Two rural banks (RBs), Naara with headquarters at Paga in Kassena-Nankana district and Bessfa based at Garu in Bawku East district, have participated in the implementation of group credit supported by IFAD. A third RB which started operating from October 1996, Builsa Community Bank at Sandema in Builsa district, will join them soon. The Naara RB has established within its area of operations, three agencies (at Navrongo, Kandiya and China), to facilitate deposit mobilization and credit management. Similarly, the Bessfa RB has two agencies at Bawku and Nakpanduri. The Action Aid Ghana, an NGO, has been assisting the rural community in Bawku West district to set up a RB at Zebilla. Although BOG's present policy is not to issue a license to new RBs, an exception is being made in the case of the proposed Zebilla RB based on an appraisal recently carried out by BOG. This new RB would, therefore, be a candidate to operate under the IFAD funded project and, in that event, it would be the fourth RB to assist with the implementation of the project.

Prior to the effectiveness of the IFAD-funded project in UER, i.e., at the end of 1990, both Naara and Bessfa RBs did not conform to BOG's capital adequacy requirements and were operating at a loss. Subsequently, the Naara RB was included in the first group of 20 RBs restructured under the IDA-assisted Rural Finance Project (1989-94). The Chief Executive of the Bessfa RB, who was facing charges of alleged misappropriation, was replaced. Both these RBs have benefited from IFAD support. They, along with the newly established Builsa RB, are operating at a profit, complying with BOG's prudential criteria and maintaining loan recovery rates of nearly or above 90 percent.

188. Two successive financial sector adjustment programs (1988-98) supported by the World Bank have helped restructure the DMBs. The reform programs included improvement of banking legislation and supervision, deregulation of administered interest rate structure and credit allocation, removal of subsidized lending rates of interest on credit to "priority" sectors, deregulation of foreign exchange market, establishment of a non-performing assets recovery trust and privatization of state-owned banks. Before deregulation of administered credit quotas, commercial banks were required to allocate at least 20 percent of their total credit to the agricultural sector. After the liberalization of this requirement, their credit to the agricultural sector has dropped sharply, from 31 percent of total lending in 1983, to less than 13 percent in 1998.

189. In addition to formal institutions, mainly the branches of ADB and rural banks (RBs), the rural financial sector in Ghana consists of informal institutions such as *susu* collectors, individuals who mobilize short-term savings; *susu* groups, which are rotating savings and credit groups; and traders and moneylenders. There are also some providers of semi-formal financial services. These consist of savings and credit cooperatives, also known as credit unions, some agricultural cooperatives, and a few nongovernmental organizations (NGOs) involved in rural microfinance.

Agricultural Development Bank

190. The ADB was set up in 1965 to lend mainly to the agriculture sector. It was the first bank established solely for agricultural credit in Africa, catering primarily to small-scale farmers.⁶⁴ It was first called the Agricultural Credit and Cooperative Bank, but changed its name to Agricultural Development Bank in 1979. The ADB is fully owned by government and it is run by a nine-member board appointed by the Minister of Finance. Loanable funds for the ADB came initially from government and external sources, but in 1968 the ADB embarked on deposit mobilization and is now a full-service bank.

191. Owing to inappropriate lending policies and procedures, and insufficient loan supervision and recovery arrangements, ADB had by 1987 accumulated a high percentage of non-performing loans. It was restructured in 1988 with a substantial injection of capital from the government. Since then, ADB improved its performance and has made profits, while still maintaining an agricultural focus and rural clientele.

192. At present, ADB operates in every region of Ghana through 3 regional offices and 32 branches. As of December 31, 1998, its total assets amounted to C 490 billion (US\$209 million) and its outstanding loans and advances stood at C 223 billion (US\$95 million). While agriculture accounts for most of ADB's loans and advances, a major portion of agricultural loans goes to large farmers, traders and processing units. Loans to finance food crops, which are predominantly grown by smallholder farmers, were only 12 percent of the loans to agriculture and allied sectors, and 9 percent of the total loan portfolio (Table 21).

193. The African Development Bank (AfDB), the European Union, IDA and IFAD have been key supporters of ADB. AfDB first granted a line of credit to ADB in 1980, then again in 1985 and in the early 1990s; a fourth line of credit is presently active. In 1980, EU also gave a line of credit to ADB. Under the IDA-assisted Rural Finance Project (1989-94), ADB was the bank that used the project's line of credit most extensively. A substantial portion

⁶⁴ The National Investment Bank (NIB), also created in the mid-1960s dealt with medium- and large-scale agricultural and industrial projects.

(nearly 75 percent) of the total rural credit portfolio under IFAD projects has been handled by ADB. ADB is committed to allocating up to three-fourths of its loanable resources to the agricultural sector including associated activities. However, the ADB has tended to focus on the commercial agricultural sector and on larger regional centers. It has provided little support to the needs of small farmers, and has been unable to link up with the informal financial sector.

Table 21. Outstanding Agricultural Portfolio of ADB per Sub-Sector, 1998

| Sub-Sector | Outstanding Agricultural Portfolio (In percent) | Total Outstanding Portfolio (In percent) |
|---|--|---|
| Industrial crops ⁶⁵ | 35 | 25 |
| Cocoa production and marketing | 33 | 23 |
| Food crops | 12 | 9 |
| Agricultural marketing and food processing | 13 | 9 |
| Livestock and poultry | 4 | 3 |
| Nontraditional exports ⁶⁶ | 3 | 2 |
| Total | 100 | 71 |

Source: ADB Annual Report, 1998.

Rural Banks

194. The BOG promoted the establishment of RBs in the mid-1970s because Ghana's vast rural areas were devoid of adequate banking facilities. The key objectives were to institutionalize financial intermediation in the rural areas, inculcate the banking habit among rural households, and mobilize rural savings for onlending to agriculture, forestry, fishing, and other agro-based industries.

⁶⁵ Includes cotton, groundnuts, oil palm, rubber, and soybean.

⁶⁶ Includes cashew nuts, coffee, cut flowers, pineapple and vegetables.

195. In July 1976, the first rural bank of Ghana was established at Agona Nyakrom in the Central Region. Since then, the number of RBs has grown steadily, from 20 in 1980 to 122 by 1990, and further to 132 by 1998. In June 1999, there were a total of 111 rural banks located in nine regions (Tables 22 and 23), after the decision of BOG to close down 21 distressed banks. RBs are widely dispersed, but their regional coverage is unequal. There is a high density of rural banks in Central, Eastern, Ashanti and Brong Ahafo regions, while the northern regions (Upper East, Upper West and Northern) are not well served.

Table 22. Regional Distribution of Rural Banks in Ghana

(Number of banks; end of period)

| Region | December 1987 | June 1999 |
|---------------|---------------|------------|
| Ashanti | 20 | 21 |
| Central | 22 | 20 |
| Eastern | 19 | 19 |
| Brong Ahafo | 15 | 17 |
| Western | 10 | 12 |
| Volta | 12 | 8 |
| Greater Accra | 5 | 6 |
| Northern | 0 | 3 |
| Upper East | 2 | 3 |
| Upper West | 2 | 2 |
| Total | 107 | 111 |

Source: Bank of Ghana.

196. Essentially, RBs are unit banks incorporated as limited liability companies. They were initially owned jointly by the people in their catchment area and the Bank of Ghana. The local people owned ordinary shares, and the Bank of Ghana, preference shares. Since 1994, the BOG no longer participates in the ownership of newly created rural banks. However, it continues to retain shares in most of banks that were set up before 1994. In general, the ownership of RBs is broad-based and confined to communities within which they are

located.⁶⁷ Their area of operation is generally about 20 miles (32 km) around their headquarters. The distinctive features of RBs are a rural base, private character and community identity and patronage. Although RBs are supposed to function as unit banks, some of them have opened resource mobilization agencies in nearby urban areas. They are usually managed and operated by the residents of the locality who have the advantage of familiarity with prospective clients and local conditions.

197. For any RB to qualify for a license from BOG, it must: (a) collect a minimum share capital of C 50 million; (b) ensure that no single individual or company holds more than 10 percent and 20 percent of the share capital, respectively; and (c) submit for BOG review a feasibility report of its business prospects.⁶⁸

198. RBs are subject to the same degree of BOG supervision as the DMBs. Like the latter, they have to operate in conformity with the Banking Act of 1970 as amended in 1989. In addition to compliance with capital adequacy requirements, RBs have to: (a) maintain a primary reserve in the form of cash and balances with other banks of not less than 10 percent of deposit liabilities and a secondary reserve in the form of treasury bills and other money market instruments of not less than 52 percent of their deposit liabilities; (b) transfer a minimum of 50 percent of their annual net profit after tax to their reserve fund; and (c) seek ratification of BOG's Rural Finance Inspection Department before disbursement of loans of C 2 million or more to a single party and all loans to directors or companies in which they have an interest.

199. The Association of Rural Banks (ARB) was founded in 1981 to promote and strengthen the RBs. All but one rural bank are currently members of the ARB. Its main role is to serve as an advocate for rural banks and to provide supporting services to them, including technical assistance. In some cases, the Association has been called upon to mitigate conflict between managers and boards—usually over remuneration and exercise of authority. However, the ARB has limited influence on banks. It provides banks with advice but if the banks do not accept it, the ARB can only initiate concrete actions through the Bank of Ghana. With no legal authority to enforce its recommendations, the association has to resort to moral suasion.

200. There has been considerable increase in rural financial intermediation by RBs in recent years (Table 24). However, growth in RB outstanding credit was somewhat weaker despite

⁶⁷On average, about 300-400 shareholders for a new bank, and up to about 1,000 shareholders for any RB in existence for 5 years or more.

⁶⁸Pending organization of the proposed Apex Bank (see below), BOG's policy is to be extremely cautious in granting new RB licenses. The minimum share capital was raised to C 100 million in October 1999.

considerable amounts of lending under externally assisted projects. This was due to some extent to an increase in reserve requirements. Moreover, with the treasury bill rate near or slightly below the average bank lending rate for agriculture, manufacturing and trading, RBs actually maintained a high share of their deposits as primary and secondary reserves, ranging between 65 and 80 percent of deposits in 1994-98, and with interest rates on deposits being highly negative, they had no problems in ensuring their financial viability in a highly inflationary macroeconomic environment. Since then, interest rates have declined endangering the RBs financial viability, because of the high secondary reserve requirement.

Table 23. Important Financial Indicators of Rural Banks, 1993-98

(In billion of cedis; end of period)

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|-------------------------------------|------|------|------|------|-------|-------|
| 1. Number of banks | 123 | 125 | 125 | 129 | 132 | 132 |
| 2. Total assets | - | - | 45.3 | 72.5 | 108.1 | 164.3 |
| 3. Deposits | 13.2 | 16.0 | 33.5 | 50.1 | 76.0 | 114.0 |
| 4. Outstanding credit ⁶⁹ | 6.8 | 7.8 | 14.4 | 24.3 | 36.4 | 54.0 |
| 5. Primary / secondary reserves | 9.4 | 10.5 | 23.4 | 37.7 | 49.5 | 91.3 |
| - in percent of total deposits | 71 | 66 | 70 | 75 | 65 | 80 |
| 6. Shareholders funds | - | 1.3 | 3.2 | 4.7 | 7.4 | 11.4 |
| 7. Treasury bill rate (in percent) | 32.0 | 29.5 | 40.5 | 42.8 | 42.5 | 26.8 |

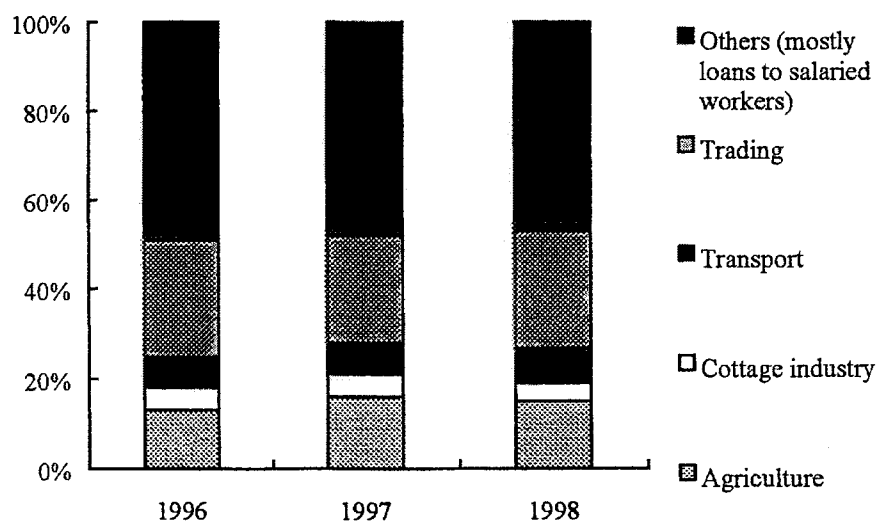
Source: BOG Annual Reports.

201. Initially rural banks were required to comply with sector guidelines in respect of their loan portfolio composition. In the mid-1980s, the loan requirement for agriculture was 45 percent and for cottage industry 30 percent of total loans. These requirements were however discontinued at the beginning of 1990s. An analysis of the distribution of loans and advances during 1996-98 period reveals that the share of credit accruing to agriculture is only 13-16 percent, while the share of the category "other credit", which comprises mainly loans to salaried workers is about 50 percent of the total (Figure 20). The extension of a disproportionate amount of credit to salaried workers stems from the low risk associated with such loans, which are potentially deductible at source from the worker's steady flow of income. However, most salaried workers live in urban centers.

⁶⁹ Inclusive of funds onlent under externally assisted projects.

202. The majority of the RBs can only claim a small number of clients and they mobilize modest amounts of savings and disburse few credits, either directly or indirectly—especially when compared to total rural population numbers and total savings and credit needs in Ghana. Nevertheless, RBs have been reasonably successful in mobilizing rural deposits, mostly in the form of savings and time deposits. The total number of deposit account holders rose from 625,000 in 1995 to 780,000 in 1997, a growth of over 25 percent. RB deposits include funds of informal deposit takers, such as susu collectors, which play an important role in bridging informal and formal entities. While RBs deposits grew in nominal terms nearly nine times from C 13.2 billion in 1993 to C 114.0 billion in 1998, they account for only three percent of deposits with the formal banking system. However, RBs have ample potential to expand their client base, since 68 percent of Ghana’s population is located in rural areas.

Figure 20. Ghana: Distribution of Outstanding Loans and Advances of Rural Banks by Sector, 1996-98
(In percent of total; end of period)



Source: BOG Annual Reports.

203. The BOG has an annual grading process for all the RBs, based mainly on the capital adequacy ratio (CAR), size of paid-in capital (minimum of C 30 million), net worth, and profitability. The CAR is essentially the proportion of the RB’s capital base to risk assets. The capital base consists of paid-in capital, reserves and accumulated profit less fixed assets, preference shares, subsidiary investments and accumulated loss. The risk assets represent the total assets less cash and balances with other banks, investment in treasury bills and other money market instruments and fixed assets. RBs with a capital adequacy ratio of 6 percent or

above are classified as "satisfactory" banks; those with capital adequacy ratio between 1 percent and 6 percent are "mediocre"; while those with a capital adequacy ratio of less than 1 percent are referred to as "distressed banks." As at December 1998, 52 RBs out of a total of 132 were classified as "satisfactory," 64 as "mediocre" and 16 as "distressed."

204. Until 1990 RBs received very little institutional support. The first comprehensive support to the RBs was through the IDA-assisted Rural Finance Project (1989-94). This project helped restructure RBs, strengthen their internal control systems, and initiate training activities managed by the ARB. As a result of the project, the number of RBs adjudged as satisfactory increased from only 5 in 1990 to 55 by the time of project completion in 1995. Post-project support for training and capacity building has come from IFAD and Danida. Assistance provided by donors has been generally limited in scope and scale, often circumscribed to specific regions and lacking clear plans for expanding support in case of success. Nevertheless, the lessons from these initiatives fully justify a continued support for reform and revitalization of Ghana's rural banking system.

205. Overall, RBs have substantial potential to contribute to rural growth and poverty reduction. With the advantage of their rural orientation, they are in a position to offer simple and flexible banking services tailored to meet the peculiar needs of predominantly small rural depositors and borrowers, and increase flow of funds, through both deposit mobilization and lending, to assist rural economic activities. Having the advantage of community identity and patronage and being rural-based and community-owned, RBs are well suited to promote improved linkages with informal rural institutions and better financial intermediation in support of agricultural and rural development, while providing financial services to rural women and other disadvantaged. However, the strengthening of RBs is essential as more than 60 of them are classified as mediocre.

Semi-Formal and Informal Financial Services

206. The semi-formal financial services sector in Ghana mainly consists of savings and credit cooperatives known as credit unions (CUs). The CUs are voluntary self-help associations mostly organized in a community or workplace. They are registered cooperatives whose main activities are encouraging savings among members and lending to a limited number of their members. There are about 250-300 CUs in Ghana affiliated to the Credit Union Association. Only about 50-60 percent of them are reported to be active and most of these are urban-based. Box 9 provides a summary of semi-formal and informal financial services in the Upper East Region of Ghana, the least developed area of the country.

207. The informal financial services are provided by susu collectors, susu groups and moneylenders/traders. Susu collectors are mobile bankers primarily engaged in savings mobilization. Individual savers place an agreed amount with the collector at regular periodic intervals (usually a day or a week) for a specified period of time, after which the deposits (less a small commission) are returned to the depositor. The depositor may, in an emergency,

request that his or her money be paid out earlier than agreed. Susu collectors usually deposit the money they mobilize with a bank. In some cases, they may invest the money in their own business, or lend to others.

Box 9. Semiformal and Informal Financial Services in Upper East Region (UER)

There are 11 savings and credit cooperatives or credit unions in UER. However, most of them are made up of industrial and salaried workers and none of them is engaged in providing financial services to rural communities. Among the semi-formal financial service providers in UER, some NGOs are important as promoters of rural savings-cum-credit groups. Some examples of their operations include:⁷⁰

- **Action Aid Ghana:** Organized 140 groups of rural poor in Bawku West district, of which 80 percent are women's groups. Credit activities include seed credit and credit for informal group associations (IGAs). Groups must save up to 20 percent of credit required.
- **Bawku East Women's Development Association (BEWDA):** Serving 33 women's groups in Bawku East district. Credit activities cover rainy season crop production, dry season vegetable gardening and petty trading. Groups' own savings is essential to qualify for credit.
- **World Neighbor Program for Strengthening Community Organization:** Serving 10 groups of women and men. Credit is for IGAs. Groups must save up to 10 percent of credit required.

The group savings-cum-credit activities of NGOs are constrained by lack of funds. The preference of NGOs also is to disengage from direct administration of loanable funds and concentrate on training and capacity building activities.

The system of susu collectors is developed in the main towns of UER—Bolgantonga, Bawku, Navrongo and Sandema. In these towns, moneylenders also operate mainly to meet emergency demands of cash, but charging high interest rates of up to 200 percent. In rural areas where susu collectors are usually absent, susu clubs or rotating savings and credit associations/clubs are the most common form of group to person financial management arrangements, especially among rural women. These clubs have the advantage of being user-owned and non-profit entities.

208. Susu groups are also engaged primarily in mobilizing savings, but group members organize the arrangements for collection and payment collectively. A variation of the susu system is what is described as rotating savings and credit associations/clubs (ROSCAs). Under this arrangement, a number of people come together (through a self-screening process) and decide on how much each member should contribute on a regular basis. Total collection for each period is given to one member in rotation. This system is popular in many rural areas, especially among rural women who seek to establish an IGA, including a farm other than the

⁷⁰ Source: GTZ, *Microfinance and Poverty Alleviation in Northern Ghana: The Case of the Upper East Region*, August 1997.

collective family plot. The expression "susu" is used for both susu groups and susu collectors. The susu groups or ROSCAs offer a ready-made and sound foundation for organizing and developing self-help savings-cum-credit groups and linking these informal channels with formal banking institutions to enable the latter to undertake cost-effective rural financial intermediation.

209. Moneylenders/traders are usually rich farmers who have their own cash to lend or have access to the formal financial system. Their local knowledge enables them to provide ready credit. However, they usually collect interest at a high rate, are not involved in savings mobilization, and may not necessarily lend to finance a productive activity. They also often have a narrow capital base.

C. Constraints

Rural Banks

210. Rural banks have been operating within a macroeconomic environment with very high inflation since 1992. This is a major constraint since rural financial services cannot meaningfully develop in a climate of high inflation, which particularly affects the poor owing to their lack of diversification into non-cash assets.⁷¹ Although reasons for mixed performance vary from bank to bank, the key underlying features are poor management, compounded by inadequate oversight from the board of directors, low staff quality, which is exacerbated by the poor location of the banks with respect to the money market centers, and weak internal controls.

211. Because of the isolated nature of the communities in which rural banks operate, with limited social services, these banks face severe difficulties in recruiting qualified personnel. As a result, the majority of directors are often recruited from the ranks of local citizenry in the catchment areas of the banks and may lack knowledge of banking and finance, a situation which has contributed greatly to the poor management of these banks. Rural banks also face a lack of infrastructure and logistic support, which hamper their operations. Specifically, banks have very weak legal instruments for debt recovery, which impedes the recovery of overdue loans, and undermines a revival of confidence in the rural banking system. Poor management and weak legal instruments have impacted negatively on regulatory controls and the financial viability of the banks.

⁷¹ High inflation also tends to discourage financial savings and reduce monetization in the economy.

212. Lack of experience and capacity in effectively mobilizing customers has led to the financing of artificial groups of producers, many of which disintegrate after the credit is disbursed. In addition, the quality of feasibility studies required for establishing rural banks has been generally low, thereby leading to the improper location of some banks.

213. The physical isolation of the banks from the money market centers, coupled with communication and other infrastructure problems, has adversely affected the banks' abilities to invest their surplus funds on a daily basis, and thus has limited their profitability. These issues have limited the array of services available to clients, such as check clearing, and have constrained the adoption of new technologies and contributed to the high transaction costs.

214. Inadequate bookkeeping, nonobservance of internal control measures, and lack of regular internal auditing are the main regulatory problems facing the banks. A high level of secondary reserve requirement (52 percent of deposits) has acted as a disincentive for rural banks to invest in the rural sector and instead forced them to hold risk-free and high-interest bearing treasury bills. Consideration could be given to reducing the secondary reserve requirement once the share of bad loans in RBs' portfolio falls to a reasonable level.

215. Most of the rural banks are inadequately capitalized, which has constrained their ability to perform at the optimum level. Their customer base tends to be narrow, and their deposit base is correspondingly low owing to limited business opportunities in the rural areas. This situation has tended to make some of the banks depend mainly on the handling of payment of cocoa purchases, meaning that when the cocoa season is over, the rural banks become idle. This results in a drastic reduction in the mobilization of funds and hence considerably reduced profits.

216. The financial viability of rural banks rests on a combination of institutional strength, operational feasibility and adequate regulatory controls, since these affect the banks' capacity to mobilize and distribute funds, as well as ensuring that money is well managed while in the bank's possession. Key requirements for the upgrading of Ghana's rural banking system are the improvement of the management of banks and an increase in the volume of transactions conducted by them, as well as widening their range of services by deepening the linkages with the informal sector.

Community Groups

217. As mentioned previously, the rural poor in Ghana, as in most of Africa, face many problems which limit their access to credit from formal providers. Physical location in relation to the financial institution, combined with problems of transport, limits the accessibility of financial institutions. These in turn encourage the poor to rely on informal networks which are closer to home, despite the fact that these lend at higher rates of interest and thereby perpetuate the cycle of poverty. Another factor forcing the rural poor to rely on informal lenders is their lack of collateral. Informal financial services tend to be more flexible than the

formal ones in terms of collateral requirements, and therefore attract more clients from the ranks of the poor. Lack of literacy is another limiting factor facing the rural poor in their quest for credit. Finally, the terms of the loan are more easily negotiated with flexible informal lenders, than with rural banks, thereby further encouraging the borrowers to remain with the informal providers.

218. The World Bank's experience with the Ghana Microfinance Institution Action Research Network highlights the specific problems facing female beneficiaries with respect to participation in development initiatives. Though the problems outlined above are also true for men, women tend to experience them more acutely, since they are exacerbated by women's lower levels of education, increased workload owing to both their reproductive and productive roles, and their lower position in society. Women therefore rely on informal suppliers such as susu collectors, and semi-formal suppliers, such as NGOs and community-based organizations, to a greater extent than their male counterparts, though the size of the loans that they receive are usually smaller than those given to men. Savings mobilization and credit provision are the core services provided by these semi-formal institutions to women.

219. Within a rural context, microfinance institutions target rural women using the group lending mechanism to ensure joint liability for securing loans. This strategy is cost-effective in increasing the number of clients to credit staff ratio. This is important in order to reduce the cost of reaching isolated rural communities. Group development training also equips rural women with decision-making and leadership skills. They select group members, make loan decisions, and are active within microfinance operations.

220. Key means of addressing the constraints facing women in terms of access to credit include the linkage of susu collectors with banks and collaborative arrangements with other financial networks. These are discussed in more detail in the Section IV.

Informal Sector

221. The informal sector is large and disparate, with little cohesiveness, factors that limit its effectiveness. The informal sector is often perceived negatively by outsiders; images of exploitative moneylenders and exploited cultivators have formed powerful arguments for the provision of cheap targeted credit and the establishment of formal financial institutions for rural finance. These groups do, however, offer a range of services, which are invaluable to disadvantaged client groups.

222. Individually, informal entities are small and lack impact, particularly because of their low asset base, and they have high transaction costs. Their savings mobilization and lending activities are often not sustainable over the long-term. They do, however, represent a key to the viable operation and greater effectiveness of Ghana's rural banking system through increased linkages between the two. Promoting these linkages between the formal and informal financial sectors, which would include improving the assessment of loan suitability,

could address the issue of sustainability of the activities financed by loans from the informal sector, which otherwise would remain in doubt.

D. Next Steps

Apex Bank

223. The apex bank initiative evolved out of the operational constraints currently faced by the unit rural banks and from experience of past donors' assistance in the rural/microfinance sector in Ghana. Given the unit nature of the rural banking system, individual banks lack the economies of scale to address the constraints which limit their operational efficiency, undermine depositors' confidence, and hamper the development of innovative tools and products for serving the rural clients. To alleviate these problems, the Association of Rural Banks (ARB) proposed the setting up of an apex bank, which would serve as a banker to the rural banks, while also providing them with financial, managerial, and technical support.

224. The apex bank would have a banking license. It would be owned by the member rural banks through share subscriptions and have an independent board of directors. With headquarters in Accra, it would have three strategically located branches (Kumasi, Takoradi and Tamale) to provide broad coverage to rural banks in all parts of the country. However, the apex bank is seen as more than a financial institution: it would serve as a vehicle for developing, testing and disseminating new and innovative products for serving rural clients, disseminating best practices in rural/microfinance, and assisting the rural banks to better deal with risks.

225. The apex bank would be expected to enable the rural banks to (a) expand financial intermediation in Ghana's rural areas by diversifying products, instruments and related services, and strengthening linkages with the informal sector; (b) mitigate rural banks' operational constraints, such as check clearing, specie supply, and liquidity management; and (c) promote institutional reforms leading to the overall development of a sound and sustainable rural financial system that would underpin rapid economic transformation of the rural area.

226. The first technical assessment of the apex bank was undertaken by consultants from the Philippines in 1996. After this initial study, a much broader feasibility and business plan was prepared by local consultants in 1997. This study defined the administrative, legal and financial roles and responsibilities of the apex body, its relationship with member rural banks, management requirements, and profitability. Based on this report, the ARB intensified consultations with key donors, notably the World Bank and IFAD, to provide support in developing and operationalizing the concept. Nevertheless, not all operational details of the apex bank have been clarified. During the September 1999 Roundtable Conference on the

apex bank, there was general agreement that substantial work remains to be done in better defining the legal and institutional framework, clarifying the relationships between the individual rural bank and the apex bank, and between the apex bank and the rest of the banking sector.

227. As mentioned before, the three main constraints identified by rural bank managers as hampering their operational efficiency are check clearing, specie supply, and liquidity management. Rural banks currently clear checks and seek specie replenishment through commercial banks such as the ADB and the Ghana Commercial Bank. The rural branches of these larger, Accra-based commercial banks are themselves competitors of the rural banks in activities such as cocoa purchasing, agricultural credit, and consumer loans to rural civil servants. Because rural banks depend on their competitors for the provision of these core services they are at a competitive disadvantage. Rural banks checks are often held for periods exceeding 30 days by the banks in which they held their accounts. Specie supplied to them are a combination of old, tattered, and small denomination notes and large quantities of coins. Specie is also not supplied in time, leading to chronic liquidity problems within the rural banks. Procurement of treasury bills by the rural banks, a service also entrusted by rural banks to commercial banks, are often subject to similar delays, in addition to the high fees charged. The cumulative effects of these problems are high transaction costs of rural bank operations, inefficient support of clients, uncertainties, and low depositors' confidence.

228. Beyond these factors, the establishment of an apex bank would lead to substantial economies of scale in the provision of common services. For example, the apex bank would represent all rural banks as a single entity in the national clearing system. Thus, the deposit of C 200 million required per bank for participation in the national clearing system—which is high for any individual rural banks—will be shared between the 100 or more participating rural banks, thereby making it more affordable. Additionally, the apex will provide more cost effective training by pooling resources and gaining leverage in negotiating with training centers.

229. Also, grouping all rural banks under an apex structure, with similar reporting standards and evaluation criteria, would lead to improved and timely monitoring by the Banking Supervision Department (BSD) of the central bank. Under the current situation, BSD maintains a fleet of vehicles and staff to visit each rural bank at least once a year. Given the geographical dispersion of the rural banks in all the ten regions of Ghana, the current monitoring program is proving significantly costly for the central bank, and as more banks are licensed, will be unsustainable. Other common services which could be provided by the apex include a deposit insurance scheme for rural depositors and a human resource development and personnel policy to enable rural banks attract and retain good caliber staff.

230. The apex bank project is being developed under a Transition Apex Steering Committee (TASC) chaired by the Governor of the Bank of Ghana and with broad representation from the Bank of Ghana, the Ministry of Finance, the Association of Rural Banks and the private sector. It is being supported under the IDA/IFAD Rural Financial

Services Project (RFSP).⁷² The project is estimated at US\$16 million over five years. IDA and IFAD will contribute about US\$5 million each, and other donors will be responsible for the remainder.

231. IFAD support will focus on strengthening informal/formal linkages, development and training of informal financial sector groups and associations, and capacity building within the rural banks to better link them to their rural agencies and clients. The World Bank will focus on policy and institutional reforms in the rural financial sector, and the strengthening of the BOG areas in charge of rural banks and their supervision. GTZ and Danida will provide technical support, training and capacity building within the rural banks. Assistance from the Rabobank, a community-based banking group in the Netherlands, is being sought to develop sound operational and managerial practices at the apex bank.

Informal Financial Services

232. Informal financial services can also make an important contribution to rural finance by taking care of rural customers who have no access to banks owing to their location or perceived creditworthiness. The IFAD is working with the government to develop informal financing services and their linkages to the formal financial sector.

233. Interventions aimed at strengthening links between formal (specifically rural banks) and informal financial systems and *susu* collectors should be considered. The idea is to let *susu* collectors operate as agents of rural banks to collect rural savings and provide retail credit. A Susu Collectors' Agency Arrangements Risk Fund could be established, to which participating rural banks would be asked to contribute in order to benefit from risk insurance coverage.

234. Another solution to the lack of interaction between formal and informal financial entities is the possible replication of the financial services associations introduced into Benin by IFAD in 1997. The financial services associations concept is a flexible micro-credit model for delivering low-cost financial services to rural areas by establishing village-level financial structures that are initiated, owned, and operated by the villagers themselves. In this model, savings are mobilized in the form of equity rather than debt, i.e. the financial services associations is an equity-based, shareholding company that can be linked to a formal financial institution, which then acts as a clearing house, depositing bank or as a place to invest surplus funds.

⁷² Pre-appraisal of the proposed RFSP is expected to begin in October 1999, with a possible appraisal before the end of 1999. The project should be ready for World Bank Board discussion by the first quarter of 2000 and for IFAD Board discussion by April 2000.

E. Conclusion

235. The rural financial institutions have an important role to play in rural economic development of Ghana. However, their potential is being now stifled by the lack of management capacity, inability to adopt new technologies and other constraints. Key steps to strengthen Ghana's rural financial sector in the near future are the implementation of the apex bank initiative and deepening linkages between rural banks and the informal sector.

236. Where present, rural banks are an effective instrument to link the villages with the formal banking system and to provide facilities such as savings, shares, transfer of remittances, and loans, while at the same time providing financial services associated with the inflow of civil servant salaries, pensions, and remittances. However, they have a limited ability to deal with remote villages and poor farmers, who constitute the majority of the rural population. Given the RBs' relatively limited coverage, promoting viable community-driven and locally based financial systems (informal financial services) for the rural population is an attractive approach. IFAD funded operations in Ghana have demonstrated that RBs have the potential to form lasting linkages with informal networks who are dealing with clients who do not have ready access to rural banks. In these cases they increase their impact and improve their service delivery, and are therefore key contributors to alleviating poverty.

237. The proposed World Bank Rural Financial Services Project aims to address the issues presented in this chapter in order to ensure sustainability of the financial system. It provides technical assistance to improve the quality of the staff in rural banks, as well as actions aimed at strengthening of internal controls, enhancing operation efficiency of rural banks, strengthening rural project appraisal, and testing innovative instruments. In addition, the project will support the restructuring of rural banks that have demonstrable potential to succeed. Another key component is the strengthening of operational, informational and technical linkages between informal and formal rural financial sector institutions. The program support would be for collaborative initiatives between rural banks and facilitator NGOs or community based organizations.

238. Given the current state of development of the RBs, specifically their lack of widespread coverage of the rural population, it is necessary for development initiatives to include a focus on the informal sector. Only by addressing Ghana's financial system in an holistic fashion, and utilizing the most appropriate components from each sector, will the financial system as a whole be improved, and thus contribute to poverty alleviation.

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VIII. POVERTY INCIDENCE AND REDUCTION IN GHANA⁷³

A. Introduction

239. During the period of the economic recovery program, poverty declined from nearly 37 percent in 1987/88 to about 31 percent in 1991/92, as the country achieved moderate economic growth, inflation declined from over 100 percent in 1983 to about 10 percent in 1992, and real income per capita rose at an average annual rate of 2 percent. Growth in income and expenditures was relatively broad based and did not come at the expense of a deterioration in income distribution. An important factor contributing to poverty alleviation was the persistent effort by the government to sustain public expenditures on education and health. Social expenditures increased as a share of GDP and human capital indicators improved—primary and secondary school enrolment rose, infant mortality rates declined, malnutrition among children was cut in half, and average life expectancy increased. However, poverty reduction was not uniform, declining significantly in rural areas but increasing in urban areas.

240. From 1992 to early 1997, macroeconomic stability and growth were disrupted by fiscal imbalances associated with the first two general elections in the new political environment of constitutional democracy. Domestic and external financing of budget deficits caused inflation to surge. During 1992-95, growth of real GDP per capita declined, reaching only 0.2 percent in 1994 and implying little progress or possible reversal of progress on reducing poverty (Government of Ghana, 1997).

241. In 1997, the government renewed its efforts to reduce macroeconomic imbalances, bringing inflation below 10 percent by mid-1999. By achieving low inflation, the government has established an environment conducive to reducing poverty (Easterly et al., April 1999). More is needed, however, to substantially reduce poverty and improve the economic prospects and well-being of the poor. Improving the composition and quality of public expenditure, in particular, in education and health, is also an important element of the second generation of reforms in countries like Ghana that have achieved macroeconomic stability (Camdessus, 1999).

⁷³ Prepared by Anthony Pellechio and Ritha Khemani.

B. Poverty Profile for Ghana

Poverty monitoring and indicators

242. The main source of detailed information on the social and economic conditions of Ghana's population, including detailed measures of poverty, is the Ghana Living Standards Survey (GLSS), a multi-topic household survey undertaken by the Ghana Statistical Service (GSS). Four surveys, denoted GLSS1 through GLSS4, have been conducted in 1987/88, 1988/89, 1991/92, and 1998/99, each covering a nationally representative sample of households interviewed over a 12 month period. GLSS1 through GLSS3 were used for a consistent analysis of poverty in Ghana over the years of the surveys (Government of Ghana, 1995). GLSS4 was completed in June 1999 and served as the basis for a major government report updating Ghana's poverty profile and presenting policies for reducing it.

243. In 1996, GSS adopted a new instrument, the Core Welfare Indicators Questionnaire (CWIQ) Survey, for monitoring living standards more quickly than with the GLSS. CWIQ is a nationwide probability sample survey designed to provide timely annual indicators for monitoring poverty and the effects of development policies, programs, and projects on living standards. Rather than undertake the time-consuming and computationally demanding task of measuring expenditure and income, CWIQ employs a set of indicators that are readily observable to construct poverty quintiles that are closely correlated with the expenditure quintiles based on the GLSS. The first CWIQ survey was conducted in 1997 from September to November (Government of Ghana, 1998). CWIQ is a crucial instrument for monitoring and evaluating poverty reduction efforts at the district and community level.

244. A set of poverty indicators based on the GLSS and CWIQ has been under development over the course of their preparation, implementation, and use. Development continues with consideration given to identifying indicators that change frequently and whose impact can be easily measured from year to year. Indicators under consideration include:

- *Demographic*: average household size, total fertility rate, female-headed households, and migration (rural-to-rural, rural-to-urban, and international);
- *Economic*: incidence of poverty, economic participation rate, sources and levels of income, food share in household expenditure, level of savings, source of credit, proportion of adults with access to productive assets;
- *Social*: literacy rate, primary school enrollment rate by gender, access to health facilities, health personnel consulted, percent of children undernourished, access to safety net programs provided by the Department of Social Welfare;

- *Household/community*: average number of persons per room, access to potable water, access to electricity for lighting and productive activity, and access to sanitary facilities.

Detailed profile

245. A comparative analysis of the first three GLSS surveys shows that the overall incidence of poverty in the country declined from 37 percent to 31 percent. Most of the improvement came from economic growth and the resulting increase in incomes and expenditures. Income distribution remained stable over the period and growth benefited most regions, especially rural areas. Poverty is still predominantly a rural phenomenon, with rural areas accounting for more than 70 percent of national poverty, and is primarily located in the rural savannah and forest areas, which account for about 60 percent of total poverty. In rural savannah, the incidence of poverty fell from 50 percent in 1988 to 39 percent in 1992. Wage employees in the informal sector have gained the most from economic growth, but export crop and food crop farmers saw an improvement in their expenditures. The reduction in rural poverty appears to be related to increased reliance on non-farm self-employment, particularly trading services, which are related to the growth in exports and imports (World Bank, 1995). Urban areas, other than Accra, benefited from economic growth. Although the incidence of poverty is lowest in Accra, it increased markedly from 9 percent in 1988 to 23 percent in 1992, largely the result of rural to urban migration.

246. The most important source of income for households in Ghana is self-employment, accounting for at least 70 percent of total income. This predominance is observed in all expenditure quintiles. The CWIQ survey showed 72 percent of household heads to be self-employed in 1997. In the lower quintiles, most of self-employment income is generated from agricultural activities, whereas in the high quintiles it is generated more from non-farm self-employment. Of all employed persons, CWIQ showed 93 percent to be in the private sector, with 89 percent in the informal sector and 4.2 percent in the formal sector. The two groups least affected by poverty are public sector and formal private sector employees, for whom the incidence of poverty is consistently below the national average.

247. Households headed by women accounted for about a third of households, although the level had been rising slowly. The 1987/88 and 1988/89 surveys showed the proportion of these households falling as expenditure rose. In contrast, the pattern in the 1991/1992 is inconclusive, showing the proportion first increasing and then decreasing as expenditures rose. The CWIQ survey showed 35 percent of households headed by women in 1997, with significant proportions of these households in the lowest quintile in both rural (53.3 percent) and urban (60.5 percent) areas.

248. The 1987/88 survey showed that 40 percent of the sampled population age 15 years and over could read, 39 percent could write, and 48 percent could do written calculations. These percentages showed slight improvement in the 1988/89 survey, but could not be consistently analyzed in the 1991/92 survey. In both of the early surveys, the proportions of men who could read, write, and calculate were much higher than for women, with differences

of about 25 percentage points. Both literacy and numeracy levels show a positive correlation with expenditure levels for both women and men, and are higher in urban than rural areas. The CWIQ survey showed a literacy rate of 48 percent for all household heads in 1997, with a 62 percent rate for male heads and 36 percent for female heads.

249. The CWIQ survey found a high negative correlation between education and income in both rural and urban areas and for both female and male-headed households. Poverty declined steadily with education; specifically, 54 percent of female heads and 77 percent of male heads of non-poor rural households were literate, while only 20 percent of female and male heads of households in the lowest poverty quintile were literate.

250. Overall, women experience greater poverty for a range of reasons, including: lower literacy; less access to education, employment and farm land; marital disruption; limited access to credit; and social and cultural attitudes that constrain women from making progress in business.

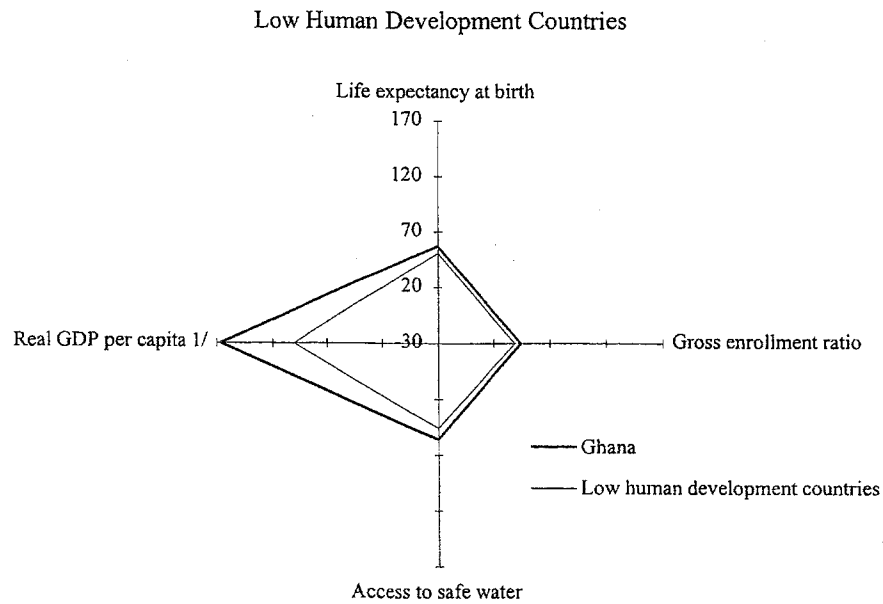
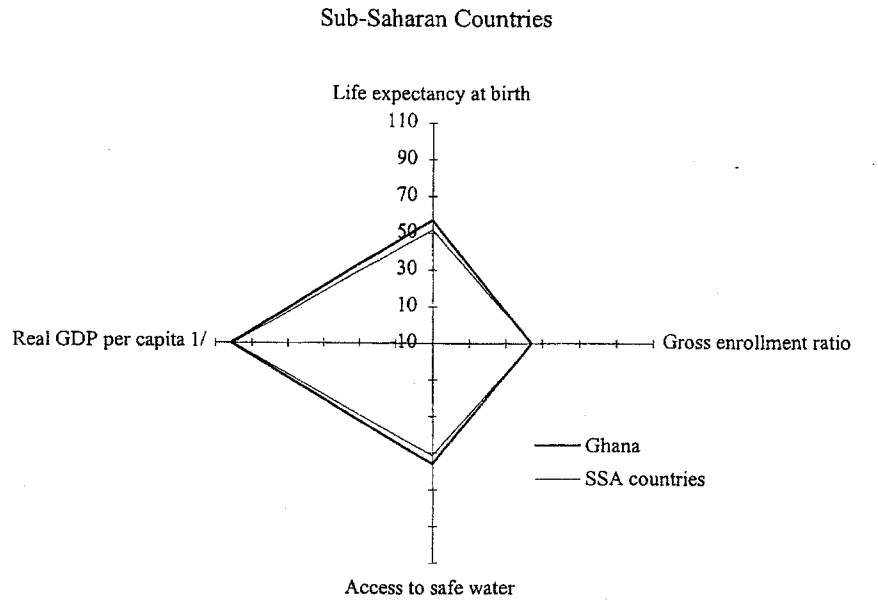
251. Literacy, basic education, health, safe water and sanitation contribute to the quality of life. Social indicators in these areas show Sub-Saharan African (SSA) countries faring poorly in comparison with the rest of the world. The UNDP's 1998 report on human development places most SSA countries including Ghana in the low human development category, although Ghana is near the top of this category based on the UNDP's human development index (United Nations, 1998). The four social indicators used in the World Bank's development diamond for Ghana in comparison with SSA countries and the countries in the UNDP's low human development category show Ghana comparing favorably (Figure 21) World Bank, 1997). Life expectancy and access to safe water are better in Ghana than other SSA countries, while Ghana is close to the average of real GDP per capita and gross school enrollment for these countries. Ghana's performance in all four indicators exceeds other countries in the UNDP's low human development category.

252. The Food and Agricultural Organization (FAO) of the UN found in its latest study of hunger found Ghana to be most successful in reducing hunger between 1980 and 1996 among African countries. Over this period, Ghana cut the proportion of undernourished in the population by over half. Progress in the 1990s has accelerated with the proportion declining from 29 percent in 1990 to 6 percent in 1997. This progress can be attributed to a number of factors, including higher expenditure on programs to provide food, donor support, and higher personal income as a result of economic growth.

253. Ghana has one of the more equal income distributions among African and SSA countries.⁷⁴ The Gini coefficients for SSA countries vary considerably, with South Africa having the highest at 62.3 in 1992, and Ghana having the second lowest at 35.1 (Table 24)

⁷⁴ United Nations Economic Commission for Africa.

Figure 21. Ghana: Development Diamonds, 1995



Sources: World Bank and United Nations Development Programme.
1/ Index based on country group average set equal to 100.

(Deininger et al., 1996). Another indicator of inequality, the ratio of the top quintile's share of income to the bottom quintile's share, shows South Africa again to have the highest inequality with a ratio of 32.1, while Ghana is at the other end of the spectrum with a ratio of 5.97. The characteristics of poverty in Ghana can be summarized in the broad categories of production, income, education, health, environment, living conditions, and water (Box 10).

Table 24. Gini Coefficient in Selected African Countries

| Country | Average Gini | First Year | Last Year | Ratio of Top Income Quintile Share to Bottom Income Quintiles Share |
|----------------------|--------------|------------|-----------|---|
| Africa | 44.71 | 1968 | 1993 | 11.61 |
| Botswana | 54.21 | 1986 | 1986 | 16.36 |
| Cameroon | 49.00 | 1983 | 1983 | ... |
| Central African Rep. | 55.00 | 1992 | 1992 | ... |
| Côte d'Ivoire | 39.18 | 1985 | 1988 | 7.17 |
| Gabon | 61.23 | 1975 | 1977 | 19.79 |
| Ghana | 35.13 | 1988 | 1992 | 5.97 |
| Guinea-Bissau | 56.12 | 1991 | 1991 | ... |
| Kenya | 54.39 | 1992 | 1992 | 18.24 |
| Lesotho | 56.02 | 1987 | 1987 | 20.90 |
| Madagascar | 43.44 | 1990 | 1990 | 8.52 |
| Mauritania | 42.53 | 1988 | 1988 | 13.12 |
| Mauritius | 40.67 | 1980 | 1991 | 6.62 |
| Niger | 36.10 | 1992 | 1992 | 5.90 |
| Nigeria | 38.55 | 1986 | 1992 | 8.67 |
| Rwanda | 28.90 | 1983 | 1983 | 4.01 |
| Senegal | 54.12 | 1991 | 1991 | 16.75 |
| Seychelles | 46.50 | 1978 | 1984 | ... |
| Sierra Leone | 60.79 | 1968 | 1968 | 22.45 |
| South Africa | 62.30 | 1993 | 1993 | 32.11 |
| Sudan | 38.72 | 1971 | 1971 | 5.58 |
| Tanzania | 40.37 | 1969 | 1993 | 6.63 |
| Uganda | 36.89 | 1989 | 1992 | 6.01 |
| Zambia | 48.97 | 1976 | 1993 | 12.11 |
| Zimbabwe | 56.83 | 1990 | 1990 | 15.66 |

Source: Deininger and Squire (1996)

Box 10. Characteristics of Poverty in Ghana

Low Production

Lack of access to land/assets
Low productive inputs
Low agricultural technology
Lack of access to credit/capital
Pricing and marketing constraints
Climatic factors
Low soil fertility
Small farm sizes
Lack of research and extension services
Low productivity

Low Income

Lack of marketable skills/untrained labor
Lack of employment opportunities
Lack of small enterprise credit
Lack of farm to market transport
Low wages
Lack of income-generating opportunities

Environmental Degradation

Farming in environmentally sensitive areas.
Soil erosion
Soil nutrient depletion
Overgrazed/depleted ranges
Fuel wood shortage
Poor environmental sanitation
Deforestation
Bush fires

Unplanned Uncontrolled Human Settlements

Lack of threshold population for service delivery
Isolated settlements
Lack of access to land
Environmental sanitation problems
High residential densities
Inadequate transportation network
Unaffordable housing rents
Slums
Lack of access to affordable housing finance

Low Level or Lack of Education

Low primary enrollment rate
Poor quality of education
Inadequate resources
Inability to pay school fees
Inadequate classrooms
Limited facilities
Poor access (distance factor)
Absenteeism

Poor Health

Food insecurity
Poor nutrition
Lack of access to potable water
Poor access to health facilities (distance factor)
Inadequate health services
Unsanitary conditions

Water

Poor water quality
Water-borne diseases
Inadequate supply
Long distances to fetch water
Inability to pay for potable water

Source: Government of Ghana, "Policy Focus for Poverty Reduction," Technical Committee on Poverty.

C. Fiscal Policies and Impacts

Overview

255. A wide range of government policies affects poverty and inequality to some degree. Fiscal policy is generally regarded as most effective in reducing poverty and enhancing equity, with expenditure policy viewed as more effective than tax policy. Further, the composition of expenditure matters. Spending on education and health, particularly basic education and health care, builds human capital which contributes to long-term growth and alleviation of poverty. An important justification for public spending on basic education is its effect on individuals' lifetime incomes, usually measured as a rate of return based on the increase in incomes generated by public expenditures on education. Many studies have found that the rate of return is highest for primary education, followed by secondary and tertiary education (Psacharopoulos, 1994). Public spending on health, especially primary care, is generally justified by its role in reducing disease in the productive years of individuals' lives. Many studies have concluded that the most cost-effective health care programs are preventative in nature, by increasing both individual productivity and the number of productive years in individuals' lives (Pradhan, 1996; Sahn et al., 1993).

256. The productivity of overall government spending on education and health has improved in Africa, but the average level of efficiency has declined relative to Asia and the Western Hemisphere. Inefficiency in African countries appears to be higher at higher levels of per capita spending and may be the result of the high share of total spending going to government wage payments (Gupta et al., 1997). This is particularly acute in the health sector, where provision of essential drugs and maintenance of facilities are underfunded. Not only is the composition of public expenditures unfavorable in SSA, the incidence of spending on education and health has been found to be unfavorable to the poor (Castro-Leal et al., 1997). For example, the poor have been shown to benefit less than the rich from education expenditures in selected SSA countries (Table 25). These results imply that higher overall spending on education and health will not necessarily improve the well-being of the poor unless measures are taken to address inefficiency, especially when the level of spending is already high.

Table 25. Benefit Incidence of Public Spending on Education in Selected African Countries

| Country | Quintile Share of: | | | | | |
|----------------------|--------------------|---------|-------------------|---------|------------------|---------|
| | Primary Subsidy | | Secondary Subsidy | | Tertiary Subsidy | |
| | Poorest | Richest | Poorest | Richest | Poorest | Richest |
| Côte d'Ivoire (1995) | 19 | 14 | 7 | 37 | 12 | 71 |
| Ghana (1992) | 22 | 14 | 15 | 19 | 6 | 45 |
| Guinea (1994) | 11 | 21 | 4 | 39 | 1 | 65 |
| Kenya (1992) | 22 | 15 | 7 | 30 | 2 | ... |
| Malawi (1994) | 20 | 16 | 9 | 40 | 1 | 59 |
| Madagascar (1993) | 17 | 14 | 2 | 41 | 0 | 89 |
| South Africa (1994) | 19 | 28 | 11 | 39 | 6 | 47 |
| Tanzania (1993-94) | 20 | 19 | 8 | 34 | 0 | 100 |
| Uganda (1992) | 19 | 18 | 4 | 49 | 6 | 47 |

Source: Castro-Leal, et al (1998).

257. Recent empirical analysis provides evidence that public spending on primary education has a greater positive impact on enrollment rates than total spending on education. The same result obtains for the effect of primary health care spending on child and infant mortality relative to total health care spending (Gupta et al., 1999). Spending on primary education and health care is more likely to improve social indicators and increase individual productivity and income, thereby reducing poverty.

Fiscal policies and impacts in Ghana

258. Under the ERP from 1983 to 1992, the government implemented programs to rehabilitate health, education, and other social sectors. The government and donors recognized that the sustainability of macroeconomic adjustment would be compromised if there were negative effects on poor and vulnerable groups. A need was identified for an anti-poverty program that would target assistance to disadvantaged groups during the transition to macroeconomic stability. To meet this need, the Program of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) was initiated in 1988 with donor support of about US\$84 million (Box 11). After 1992, it was replaced by a more decentralized system in which decisions were delegated to the district level to improve targeting of beneficiaries.

259. With the devolution of the PAMSCAD program to the district level, the central government addressed social safety net issues with specific tax and expenditures policies in the budget. For example, following the increase in the minimum wage in 1993, the minimum threshold for incomes taxes was raised and taxes for kerosene were kept lower than those for other petroleum products. Additional resources were devoted to the maintenance and rehabilitation of hospitals and schools in rural areas, as well as the construction of new district

Box 11. Program of Action to Mitigate the Social Costs of Adjustment (PAMSCAD)

Although the economic reform program focused by necessity on macroeconomic stability, exchange rate, financial, and structural adjustment policies, the government realized nonetheless that the program's sustainability depended on avoiding or at least minimizing to the extent possible negative consequences for disadvantaged groups. Indeed, the government recognized that some components of the economic recovery program "will exacerbate the economic problems of certain vulnerable groups in the short run, and this may impede the sustainability of the recovery program itself" (Government of Ghana, *Program of Action to Mitigate the Social Costs of Adjustment*, December 1987). An obvious victim of the adjustment program were retrenched workers in public sector. Hence, the government developed and began to implement in 1988 a package of measures organized under the umbrella of the Program of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) to protect vulnerable groups under the economic reform program. It focused on poor households in rural areas, especially those in the northern regions and those with limited access to income earning opportunities and social services, as well as urban poverty groups and retrenched workers from the civil service and state enterprises. The program emphasized community initiatives, employment generation through public works and food-for-work programs, training and placement services for retrenched workers from the public sector, and basic needs provision such as hand-dug wells, low-cost sanitation, essential drugs and supplemental feeding. At the central level, PAMSCAD was integrated with the government's structural adjustment program, with joint responsibility vested in the Ministry of Finance and Ministry of Local Government. A donors conference was convened in February 1988 to discuss particular projects that donors would support, which generated pledges of support amounting to US\$84 million for an initial program of 24 projects. PAMSCAD was given attention and support as an innovation in addressing social concerns while economic adjustment is being promoted. It focused on specific groups and embodied a degree of decentralized policy action. The program got off to a slow start and encountered problems. By the end of July 1990, only US\$15 million in donor financing had been disbursed. Projects were widely dispersed geographically and across sectors, which strained implementation capacity, and targeting to the rural poor was deficient. Recommendations for improvement included: devolution of responsibility for project initiation and implementation to the district level; capacity building at the district level; reduction of the number of donors involved in each project; more attention to recurrent costs; and incorporation of some projects into the regular public investment program.

health centers and schools. Retrenched public sector workers were provided severance packages and access to retraining in government tertiary and vocational education facilities.

260. The growth of real per capita expenditures on health and education has fluctuated since 1993, showing a slight upward trend recently. As a share of GDP, health expenditure has risen from 1.1 percent of GDP in 1994 to an expected 1.3 percent of GDP in 1999, while education expenditure stayed level at 4 percent of GDP for these years. Real per capita expenditures on either health or education is the product of four factors: real GDP per capita, the share of total expenditures in GDP, the share of social expenditures in total expenditures, and relative prices:

$$\psi = y \cdot E/Y \cdot S/E \cdot P/P^s \quad (1)$$

where ψ represents real per capita expenditure for health or education, S is nominal expenditure, E is nominal total expenditure, y is real per capita GDP, Y is nominal GDP, P

represents the GDP deflator, and P^s represents the price index for health or education. Over any period, the change in expenditure on health or education can be decomposed as follows:

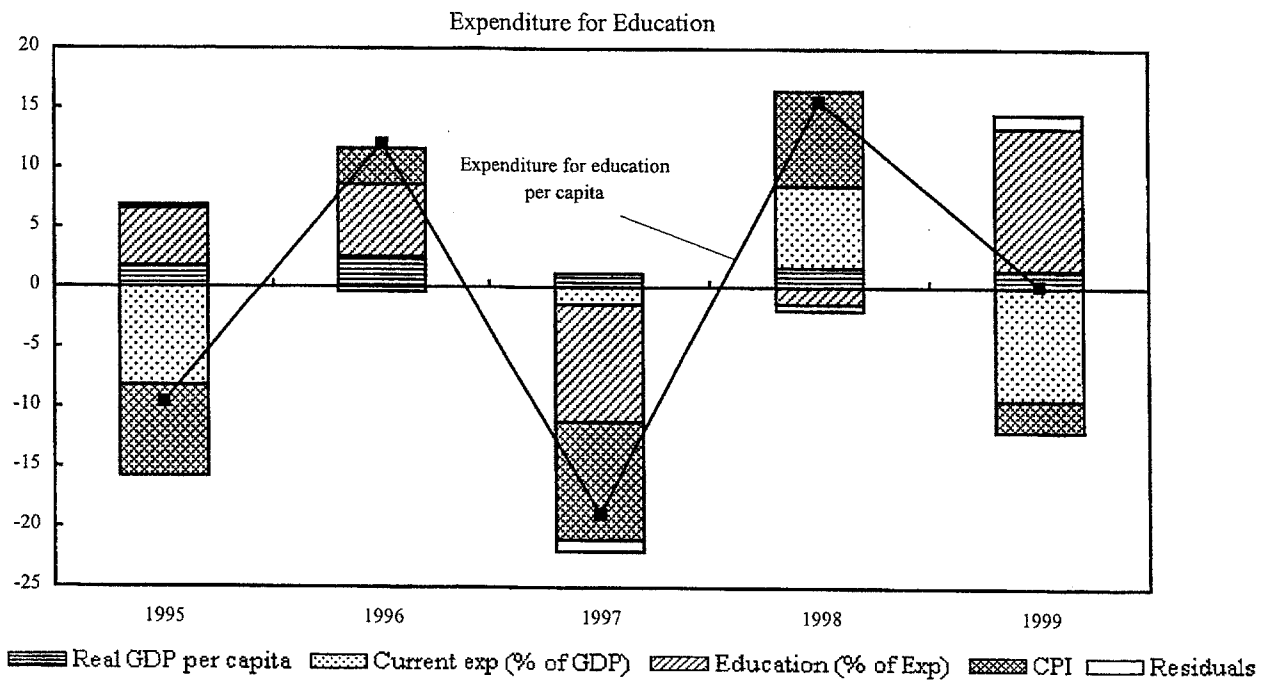
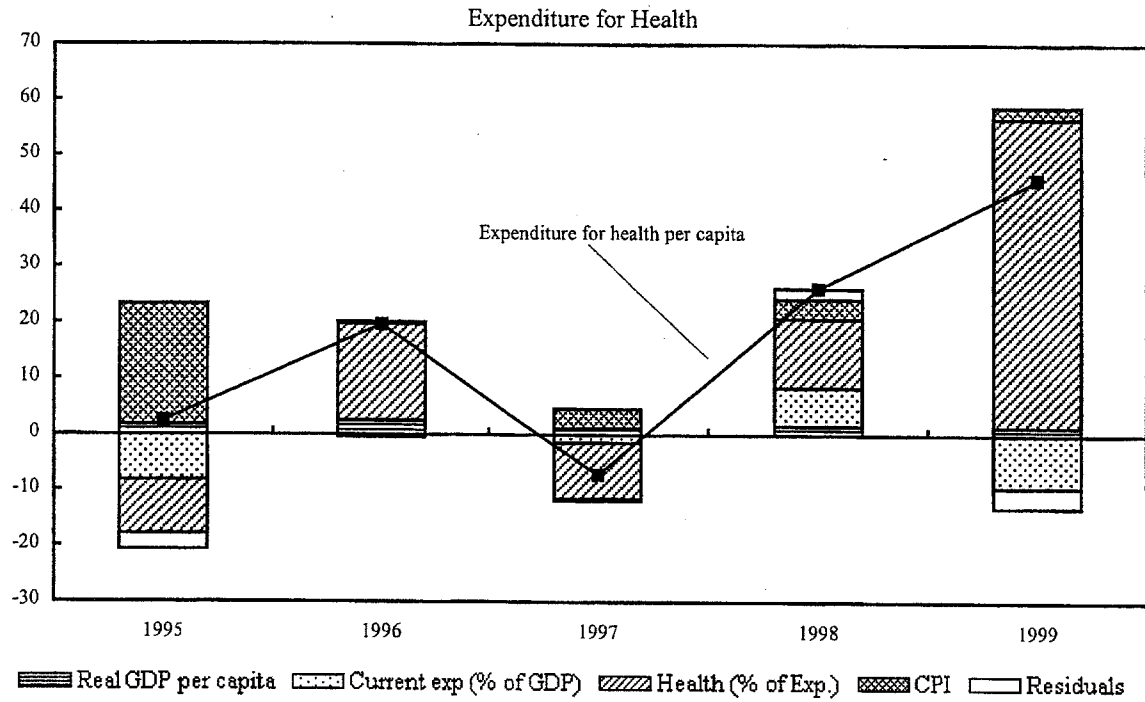
$$\begin{aligned} \Delta\psi = & \Delta y \cdot (E/Y \cdot S/E \cdot P/P^s)_0 + \\ & + \Delta(E/Y) \cdot (S/E \cdot P/P^s \cdot y)_0 + \\ & + \Delta(S/E) \cdot (E/Y \cdot P/P^s \cdot y)_0 + \\ & + \Delta(P/P^s) \cdot (E/Y \cdot S/E \cdot y)_0 + \\ & + \text{residual} \end{aligned} \quad (2)$$

where the first term represents the contribution of real income per capita, the second term represents the contribution of the share of expenditures in GDP, the third term represents the contribution of the share of social services in total expenditures, the fourth term represents the effect of relative prices, and the last term is a residual term.

261. The increase in real health expenditure per capita can be mainly attributed to a shift in spending toward health (Figure 22). The increase was, however, dampened by reductions in overall recurrent expenditures. Increases in real GDP per capita account were relatively more important in maintaining real per capita education expenditure, although a substantial projected increase in the share of spending on education in 1999 is mainly responsible for increasing the ratio of education expenditure to GDP—without this increase in education's share in spending, education expenditure's share in GDP would remain flat during 1995–99. Real per capita expenditures on health and education both declined in 1997 because their shares in expenditure both declined by 10 percent. Expenditure restraint was the mechanism for fiscal adjustment in 1997, a year when there was no program supported by an ESAF arrangement.

262. Analysis by the World Bank of the incidence of education and health expenditures in Ghana suggests that the benefits of social spending are not well targeted to the poor (World Bank, 1995). This analysis found a regressive pattern to recurrent public expenditures on health, while expenditures on education were less regressive owing to the progressive pattern of spending on primary education. Specifically, the allocations across the types of health facilities appeared to be appropriate as the poor seemed to use hospitals as much as clinics, but availability and quality of services were problems. Education spending was regressive because of the highly regressive pattern at the tertiary level. The distribution of social spending across rural and urban areas showed regressive patterns with rural areas receiving less than their share of the population as well as less in per capita terms. A clear indication of the World Bank analysis is the need to allocate social expenditures more to basic education and health where economic gains are highest.

Figure 22. Ghana: Factor Contribution to Social Expenditure, 1995-99
(Annual changes in percent)



Source: Fund staff estimates.

D. Institutional Structure for Reducing Poverty

263. The main institution with responsibility for setting and coordinating policies for poverty reduction is the Inter-Ministerial Committee on Poverty Reduction (IMCPR), whose chairman is the Minister of Finance and is responsible for coordinating donor assistance and making budgetary allocations to poverty reduction programs.⁷⁵ The IMCPR is responsible for overall policy direction and coordination of poverty reduction activities in the country. The National Development Planning Commission (NDPC) is the coordinating agency for the poverty programs of government agencies, assigning tasks to each agency with the goal of designing implementable poverty reduction programs and projects. The technical arm of the IMCPR is the Technical Committee on Poverty (TCOP) whose chairman is the director-general of the NDPC. The NDPC has a poverty reduction unit that coordinates all poverty reduction programs and activities of the TCOP. The main functions of TCOP include:

- *disseminating information on poverty reduction in collaboration with the Ghana Statistical Service;*
- *establishing policy guidelines on poverty reduction for district development plans in collaboration with the Ministry of Local Government and Rural Development;*
- *commissioning periodic impact studies for monitoring the effectiveness of approved programs and projects;*
- *developing training aids and programs to build capacity for designing poverty reduction programs at the sub-national level.*

264. The TCOP administers, manages, and coordinates all poverty reduction programs such as the National Poverty Reduction Program (NPRP) and Social Investment Fund (SIF). The TCOP also fosters linkages among non-governmental organizations (NGOs) participating in diverse donor-funded poverty initiatives, linking them to the government's development framework for poverty reduction. In order to enhance its policy making and program coordinating roles, the TCOP has established a number of technical working groups to address several aspects of poverty problems. To address poverty in a truly participatory manner under the new development planning system dictated by *Ghana—Vision 2000*, the

⁷⁵ Membership of the committee comprises the Ministry of Food and Agriculture, Ministry of Local Government and Rural Development, Ministry of Employment and Social Welfare, Ministry of Environment Science and Technology, National Development Planning Commission, National Council on Women and Development, Ghana Statistical Service, and National Population Council.

TCOP's working groups extend to all organizations interested in poverty reduction (Government of Ghana, 1995). The Thematic Group on Poverty Reduction (TWG-PR) was established in March 1999 by the NDPC on behalf of the government and UNDP on behalf of donors. In June, the TWG-PR assumed the role of the Network on Sectoral Coordinating Groups on Poverty Reduction (NSCG-PR) for preparation of a comprehensive development framework.

265. In line with its policy of decentralization, the government has established a decentralized and participatory development planning system that extends deep into the community level of local administration. The local government law of 1988 created 110 district assemblies whose responsibilities include preparation of development plans that take into consideration development needs identified by the local communities. This community participation in decision making is intended to ensure that projects and activities implemented at the local level will address the development needs and problems identified by the beneficiaries.

E. Public Policies, Strategy, and Programs for Reducing Poverty

Public Policy

266. A long-term national development policy was completed by the government at a consensus-building workshop for all stakeholders on April 1994 and presented as a comprehensive policy framework called *Ghana—Vision 2020*. The main goal of this policy is to transform Ghana into a middle-income country within the first decade of the next century so that by 2020 Ghana would attain the standard of living of middle-income country. A medium-term program for the first five-year period 1996-2000 was prepared which focused on five areas: human development; economic growth; rural development; urban development; and an enabling environment for investment and entrepreneurial activity.

267. Human development is the core area for poverty reduction. The basic goals in this area are to improve health, life expectancy, and capabilities of all persons, eliminate extremes of deprivation, and ensure an equitable distribution of the benefits of development. However, other areas also address poverty reduction.

Strategy

268. The broad strategy for poverty reduction emphasizes rural development, expansion of employment opportunities for the urban poor, and improving access of the rural and urban poor to basic public services such as housing, transportation, water supply and sewerage, and family planning services (Government of Ghana, 1996). The principal elements of the strategy include:

- *promoting equitable economic growth through sound macroeconomic policies that support employment;*
- *strengthening the agricultural sector by introducing modern farming methods and marketing practices;*
- *increasing investment in human capital so as to have a more educated, trained, and healthy labor force;*
- *providing an environment for the manufacturing and service sectors that enables creation of new business and employment in the formal sector;*
- *promoting development of an indigenous entrepreneurial class to encourage micro and small-scale business and strengthen the informal sector;*
- *developing firm targets for poverty reduction and improving data on poverty to ensure more effective targeting of poverty reduction policies.*

269. The strategy encompasses action in five priority areas; (a) economic growth, employment, and access to productive assets; (b) social services and safety nets; (c) food security and nutrition; (d) governance and decentralization; and (e) needs of women.

Programs

270. The main approaches to reducing poverty comprise central budget expenditure targeted on poverty reduction and decentralized participatory development involving local communities. The principal programs include the District Assemblies Common Fund (DACF), NPRP, and SIF.

271. The 1992 constitution provided a strong fiscal impetus to decentralization by introducing the DACF and requiring the central government to transfer at least 5 percent of domestic tax revenue to the DACF for development projects of the district assemblies. Donors also channel funds through the DACF as, for example, is the case for the World Bank's Village Infrastructure Project. The effort to decentralize the budget continued with the undertaking in the first half of 1999 of a fiscal decentralization project in the Ministry of Finance with assistance from the Canadian International Development Agency. A crucial aspect of the design of district budgets will be to ensure that they are fully compatible with the medium-term expenditure framework (METF).

272. The NPRP is a poverty reduction program funded by the government and UNDP and aimed at assisting communities in reducing poverty by identifying their needs and participating directly in developing strategies and programs. The main objectives of the program are to build the management capacity of district assemblies, community-based organizations, and NGOs to achieve better coordination of efforts; develop skills of the rural poor to generate

employment; implement the SIF; develop community and household technologies to improve productivity; and implement mechanisms to empower women and promote female education. The program covers the period 1997-2000 and is being implemented in five pilot districts (Afram Plains, Bongo, Dangme West, Ga Mashie and Juabeso-Bia).

273. The SIF is a community-based, demand-driven, rapid-disbursing fund established with support from the UNDP and African Development Bank (AfDB). The SIF is available to about six districts during the three-year pilot period, 1998-2000. Its three main goals are to facilitate access of the poor to basic social and economic infrastructure and services; provide credit to microenterprises; and strengthen local governments', community-based organizations', and NGOs' delivery of poverty reduction programs.

274. Under these funding sources and programs, resources are channeled directly to poor groups and communities through district assemblies, NGOs, and community-based organizations (CBOs) for implementation of projects that benefit the poor. For example, in addition to expenditures on health, education, and local government from the DACF, each district assembly is expected to devote 20 percent of its DACF allocation to economic activities that will generate employment and income in their communities.

275. In 1999, the TCOP began implementing a Community-based Poverty Reduction Project (CPRP) funded by the World Bank. A poverty measurement and monitoring component will identify core indicators, including district and community specific indicators, which is expected to address the limitations of the GLSS and CWIQ. Other components will address nutrition and food security, and the problem of street children.

276. The UNDP plays a critical role providing expertise across the range of issues and programs in Ghana's comprehensive participatory approach to poverty reduction. The UNDP is coordinating activities undertaken by Ghana's institutional structure for poverty reduction, working closely with the NDPC and TCOP, and serving as a secretariat for deliberations and decisions on policies, the design and implementation of programs.

F. Issues

277. Ghana made good progress in reducing poverty from the onset of its economic recovery program through 1992, with sustained economic growth and low inflation being critical for reducing poverty. Fiscal imbalances and high inflation over the 1992-96 period impeded further progress on poverty reduction, but improvements in macroeconomic growth and the decline in inflation since 1997 bring Ghana to a point where poverty can be reduced once again in an environment of sustained growth and price stability. However, good macroeconomic policies need to be accompanied by poverty reduction programs based on a comprehensive understanding of the nature and locus of poverty. Much of this will involve improving the accessibility and delivery of social services, and providing a safety net for the vulnerable population groups. Indicators for monitoring the outcomes of social assistance

based on the GLSS and CWIQ are needed to ensure that policies and programs are well designed and effectively implemented.

278. The current system of decentralized and participatory development planning must work efficiently. Each level in this system, from central agencies through community-based organizations, needs to focus on the value-added that it can bring to policy formulation and program implementation, and have the information and resources needed to meet its responsibilities. Further, district assemblies and local government should receive resources from central government and the authority to raise their own resources through taxes and fees so that they meet their assigned responsibilities in delivering social services. An important aspect of the effective use of poverty reduction resources is that they should not go too much to project management instead of the poor. Government policies and actions must be effective, and, especially at the local level, focused on service delivery and goals.

279. The medium-term expenditure framework (MTEF) should remain at the center of efforts to develop a rational basis for annual budgeting and to provide the framework for the poverty reduction program. In particular, steps need to be taken to ensure that actual disbursements are in line with budgeted expenditures. Projects need to be monitored to establish whether their objectives are being achieved, and if not, to ensure that corrective action is taken quickly. The MTEF represents the best process for improving the efficiency of health and education spending, including identifying and rectifying imbalances between wage and non-wage expenditures.

280. The capacity of district assemblies, local governments, and communities for pursuing and completing activities in the MTEF, and meeting timetables and targets, needs to be factored in project design and implementation. In this context, the problems causing delays in the release of project funds, which affect service delivery, need to be solved. Strengthening the capacity of sub-national agencies will not only contribute to realistic budgeting under the MTEF but also broaden the consultation process of the MTEF.

281. Strengthening the capacity of sub-national agencies is, in turn, closely linked with public service reform. A well-structured and efficient public service is essential for designing programs and providing services to reduce poverty. The devolution of staff resources to sub-national agencies is an important element of public service reform supporting Ghana's broad participatory approach to poverty reduction. It is critical for strengthening the capacity of sub-national agencies to meet their assigned responsibilities in Ghana's poverty reduction strategy.

282. Donor and NGO support for poverty reduction activities need to be coordinated and incorporated in the MTEF. Ghana already has put in place mechanisms for achieving this—specifically, the DACF, NPRP, and SIF. The administration and operation of these mechanisms should enhance complementarities and reinforce linkages among donor-financed activities and NGOs' projects.

283. Finally, the financial support and expertise of the World Bank and UNDP represent considerable resources available to Ghana that can substantially improve progress across the entire agenda for poverty reduction.

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