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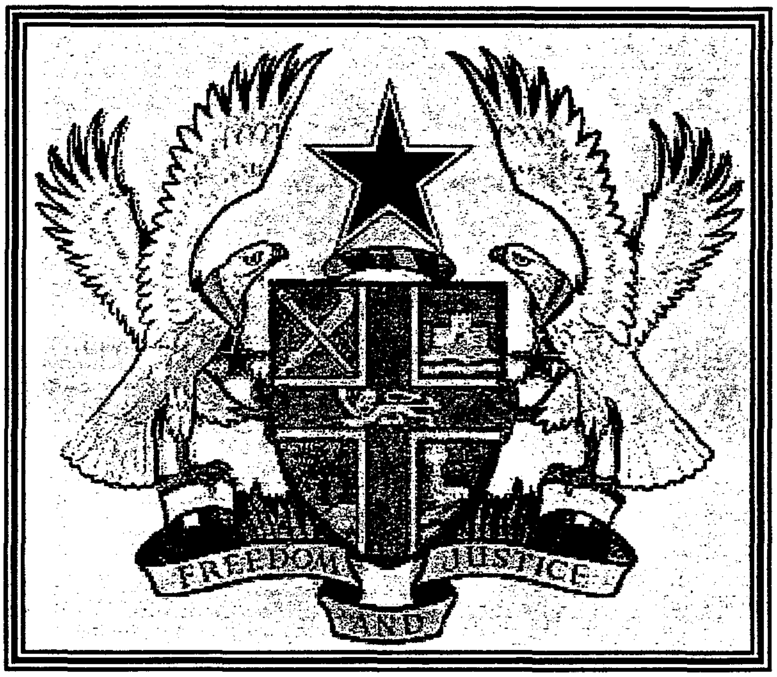
Ghana
Reaching the Next Level Through Global Competitiveness: A Public/Private Partnership

Summary of Conference Proceedings



June 1 - 6, 1997
Chapel Hill, North Carolina

Sponsors:
The Private Enterprise Foundation of Ghana, The Government of Ghana,
USAID/Ghana, Sigma One Corporation

Hosts:
Sigma One Corporation
The Frank Hawkins Kenan Institute for Private Enterprise

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Ghana - Reaching the Next Level Through Global Competitiveness: A Public/Private Partnership

Summary of Conference Proceedings

June 1-6, 1997
Chapel Hill, North Carolina

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Executive Summary

GHANA: Reaching the Next Level Through Global Competitiveness: a Public-Private Partnership

A conference for Ghana's public and private leaders hosted by Sigma One Corporation and the Frank Hawkins Kenan Institute of Private Enterprise at the Friday Center of the University of North Carolina in Chapel Hill (June 1-6, 1997[1])

Ghana Vision 2020: A Middle Income Country by the Year 2020

Ghana seeks to become a middle income country by the year 2020. This ambitious objective, embodied in the Government's Vision 2020, requires an average annual growth rate of 8% from 1995-2020. Maintaining the present policy framework, and thus its historical growth rate, will only achieve half of what is required--Ghana must work twice as hard. The accelerated growth needed to attain the objective of Vision 2020 can only come from a radical and sustained shift in the policy framework, to one that effectively implements an outward-oriented growth strategy. To achieve the required growth rate, exports must grow at least 10% per year--doubling every seven years. But traditional exports, currently accounting for 85% of total exports, are projected to grow at most by 5% per annum. This means that non-traditional exports must be the new engine of growth, growing at more than 15% per year from now to 2020. Export growth rates of this magnitude will result only if the entire economy is focused on international competitiveness.

The North Carolina Conference for Ghana's leaders was unprecedented in that it convened a broad cross-section of the Ghanian polity to discuss difficult choices facing Ghana as it seeks to achieve Vision 2020. This conference was conceived in March 1997, at a workshop in Akosombo sponsored by the Private Enterprise Foundation (PEF) with support from USAID/Ghana. The conference at Akosombo initiated a public/private partnership for making the difficult choices required by Vision 2020. At Akosombo it was recognized that Vision 2020 goals could not be reached by business as usual. A set of pressing issues evolved out of that conference: controlling inflation, increasing the productivity of all resources, judicial system reforms, financial system reforms, and the "formalization" of the informal sector. Conferees agreed that PEF, with Sigma One Corporation support, would organize a follow-up meeting in North Carolina for public and private sector leaders to forge a consensus on the strategy to be executed for reaching the next level of international competitiveness. This document communicates the essence of the consensus achieved by Ghana's leaders for reaching Vision 2020.

The leadership at the North Carolina Conference committed Ghana to international competitiveness as the way to promote broad-based and rapid economic growth. The participants recognized that the current policy framework in Ghana fails to promote broad-based and sustainable economic growth because many aspects of the policy framework stifle the economy's ability to compete internationally. The policy impediments to competitiveness were presented and discussed and recommendations formulated to address the impediments.

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[1] Sponsors of the conference were the Private Enterprise Foundation of Ghana, Government of Ghana, USAID/Ghana and Sigma One Corporation.

International Competitiveness Will Determine Ghana's Well-being in 2020

International competitiveness is the ability of an economy to convert its domestic resources into goods and services at costs equal to or lower than the prices determined by world markets. The resulting output can be consumed directly by the society, used as productive intermediate inputs, or exchanged internationally for those goods and services that the economy cannot produce efficiently. Therefore, highly competitive economies can achieve high levels of well-being for their population by producing for domestic consumption and, importantly, by converting their exports into claims on more goods and services from the rest of the world. Higher levels of international competitiveness will therefore improve the well-being of all Ghanaians.

International competitiveness in Ghana, as elsewhere, is the result of the inherent productivity of its citizens and of its natural resource endowment. Government policies are fundamental in determining the effectiveness with which human efforts and natural resources can be converted into tradable goods and services. Policies that influence the vocation of humans and the allocation of natural resources are the proximal determinants of international competitiveness. This means that policies, such as the wage policy of government and its effects on the labor market, determine whether households migrate to urban areas or remain on the farm to supply products to domestic and international markets; and in urban areas whether they are able to join the formal labor market or will remain marginalized as microentrepreneurs. The extent of poverty in Ghana is a consequence of prior policy choices; the future well-being of Ghana will be determined by the policy choices made henceforth.

The determinants of international competitiveness are the policies and resulting performance of the labor market, financial markets, the trade regime, the public sector, and the division of effort between public and private initiatives. Together, these determine the economy's ability to respond to opportunities and shocks in the global markets in which a small country like Ghana must operate. ***Ghana's present ability to compete in global markets is hampered, because the present policy framework makes Ghana a high cost, high risk economy, and chronic inflation is the patent symptom of the costs and risks of doing business in Ghana, today.***

In Ghana, as in all economies, the labor market always bears the burden of any and all distortions in the policy framework. The most notable symptoms are informality of the labor force and low labor productivity. Labor in Ghana is costly in spite of low wages, because the financial markets prevent the use of modern technologies and adequate inputs. Financial markets are dominated by the government's need for financing and thus starve the private enterprise sector of needed capital. Labor is also costly because the labor market is rigid as a result of work practices, tenure rules, and emoluments that cause severe mismatching of skills to tasks. The trade regime is administered in a cumbersome manner, in spite of significant liberalization and tariff reductions, and a significant anti-export bias remains which negatively affects employment and labor earnings in all sectors.

The presenters of policy briefs urged the conference to adopt a strategy fully committed to increasing international competitiveness. There was a strong and broad consensus on such a strategy, and that the strategy must be implemented rapidly and in an unwavering fashion until Vision 2020 is achieved.

Elements of a Strategy for Reaching the Next Level of International Competitiveness

The Ghanaian Delegates to the North Carolina Conference agreed on the following principles as elements of a strategy for rapid economic growth and the achievement of Vision 2020:

- The conference recognized that in Ghana inflation is a monetary phenomenon that arises primarily from the government's expenditures in excess of receipts. The clear conclusion was that the broad budget of government must be financed in non-inflationary manners, primarily from recurring revenues. There was not a consensus on the revenue side, and some called for increasing revenues, along with reductions in expenditures. Others, including the resource persons, pointed out that Ghana's government already absorbs too large a share of the economy for its stage of development, and that increasing revenue collections will further erode the ability of the private firms to compete in world markets.

- There was a clear consensus on the need for expenditure control, and rigor in using non-inflationary means of financing the government. In this vein, some expressed concern that external funding of government projects be carefully reviewed for their inflationary risks.

- In keeping with the foregoing, the conferees recommended that the budget and its financing mechanisms be vetted in advance of the budget year with guaranteed adherence unless legislative approval is granted for exceptions. The exchange rate should not be used as an anchor for the economy, but rather strict monetary targets should be set and fulfilled. Interventions in the foreign exchange market add costs and risks to all private enterprise activities.

- All sectors, including government, should strive for efficiency in their revenue generating and taxation role. Aside from the lack of consensus on the need for increased revenues, there was recognition that a broader tax base would be consistent with increased international competitiveness. The prices of publicly provided goods and services, such as petrol and energy, should be priced to insure full cost recovery under efficient delivery systems. This will promote competitiveness by reducing the risk of off-budget expenditures, stimulating the efficient use of scarce resources, and improving the availability and reliability of public services. Accordingly, wages should be tied to labor productivity.

- Domestic savings are too low to sustain rapid growth and to attract foreign investment. It was recognized that chronically high inflation is the principal deterrent to higher savings rates. Rising incomes will generate higher levels and rates of domestic savings, if the financial institutions develop appropriate instruments and incentives for savers in Ghana.

- The investment regime remains over-burdened with regulations and bottlenecks. Further regulatory and administrative reforms are needed. Public entities in the investment promotion and administration network need to develop pro-business attitudes among their staff members. Such institutions should support the private investment process not control it, i.e., "don't pick winners" (or losers), but support the private sector entrepreneurs once they take the risks.

- The trade infrastructure ports, airports, roads and over-land ports of entry must be upgraded to attract foreign direct investment. The financing of these upgrades will require private participation under the build, own and operate and build, operate and transfer concepts. These efforts are needed if Ghana is to be the Gateway to Africa.

- Financial sector reforms must be built upon sound macroeconomic management that insures stability in prices and exchange rates. The present system cannot attract or reward domestic savings in the range of 25% of GDP as required for Vision 2020. There are missing institutions and instruments in Ghana's financial system, and those that exist serve the financing needs of government, primarily. Financial reform must include revisions of enabling legislation and specification of the legitimate roles of oversight and supervisory bodies and entities. Adequate financial supervision is needed to create confidence among savers and investors in Ghana's bank and non-bank financial institutions. Pension reform and transparency in the SSNIT investment portfolio are priorities in harnessing existing domestic savings. Increased privatization is called for throughout the system.

- Vision 2020 requires the efforts of all Ghanaians. In Ghana the majority of the productive resources, particularly human resources, operate outside the formal system as a result of a cumbersome business environment and narrow tax base. Small enterprises must be incorporated into the growth processes through streamlining the legal and regulatory environment, broadening the tax base and reducing tax rates. The conference adopted a concept called "Push-Pull" aimed at promoting effective business linkages based on mutual gain between small and large enterprises. "Push-Pull" requires a reduction in the riskiness of business and the creation of mutual trust through enforceable contracts and successful and profitable experiences among business partnerships.

- It was stated clearly that the costs from "administrative hassles" and sluggish customs clearance procedures, etc. are a disproportionately larger burden on smaller enterprises, and such factors reduce the competitiveness of the economy in general. Much of the informality that exists is a response to these burdens as small firms attempt to avoid these costs of doing business in Ghana.

- The conference forged an effective public-private partnership for achieving the social, economic and political goals inherent in Vision 2020. The partnership calls for agreement on goals and open debate on the means needed to achieve these. The consultation between the partners will be frequent, informed, respectful, candid, polite, and inclusive. All constituencies are welcome to participate in the consultations, and all consultations will be open to all. The first consultation is to convene a summit for national economic consensus as soon as possible. The mandate of the first National Summit will be to address pressing economic issues that affect private sector performance and the performance of the national economy as a whole. The Private Enterprise Foundation was designated as the convener of the summit and the President of the Republic as the leader of the summit.

INTRODUCTION

Ghana seeks to become a middle income country by the year 2020. This means that current per capita incomes would more than triple. This ambitious objective, embodied in the Government's Vision 2020, requires an average annual growth rate of 8% from 1995-2020. The present policy framework, established in 1983 as the Economic Recovery Program (ERP), has produced an average annual growth rate of just over 4%. Maintaining the present policy framework, and thus its historical growth rate, will only achieve half of what is required--Ghana must work twice as hard to achieve its vision of itself as a middle income country. In recognition of this and of the need to attract international investors and clients, Ghana's private and public leadership met in Chapel Hill, North Carolina from June 1st to 6th, 1997, to forge a partnership for reaching the next level of economic performance. This document communicates the essence of the issues and strategies for reaching Vision 2020 that emerged from the North Carolina Conference.

International Competitiveness: The Focus of The Public Private Partnership

International competitiveness is the ability of an economy to convert its domestic resources into goods and services at costs equal to or lower than the prices determined by world markets. The resulting output can be consumed directly by the society, used as intermediate inputs, or exchanged internationally for those goods and services that the economy cannot produce efficiently. Therefore, highly competitive economies can achieve high levels of well-being for their population by producing for domestic consumption and, importantly, by converting their exports into claims on more goods and services from the rest of the world. Higher levels of international competitiveness will therefore improve the well-being of Ghanaians. Greater international competitiveness is the key to achieving Vision 2020.

International competitiveness in Ghana, as elsewhere, is the result of the inherent productivity of its citizens and of its natural resource endowment. Government policies are fundamental in determining the effectiveness with which human efforts and natural resources can be converted into tradable goods and services. Thus, government's choices regarding policies are fundamental to the well-being of Ghanaian society. Policies that influence the allocation of human and natural resources are the proximal determinants of international competitiveness. For example, the government's wage policy and its effects on the labor market affect household decisions to migrate to urban areas or to remain on the farm to supply products to domestic and international markets. In urban areas government's wage policy and labor laws determine whether workers are able to join the formal labor market or will remain at the margin of the economy as microentrepreneurs in the informal sector. The extent of poverty in Ghana today is a consequence of prior policy choices; the future well-being of Ghana will be determined by the policy choices made henceforth.

Government policies affect international competitiveness and therefore societal well-being in important ways. The determinants of international competitiveness are the policies and the resulting performance of the labor market, financial markets, the trade regime, the public sector, and the division of effort between public and private initiatives. Together, these determine the economy's ability to respond to opportunities and shocks in the global markets in which a small country like

Ghana must operate. Ghana's present ability to compete in global markets is hampered, because the present policy framework makes Ghana ***a high cost, high risk economy***.

The economy-wide policy framework in Ghana today impedes international competitiveness. **Table 1** presents numerous symptoms of policies that impede competitiveness and economic growth. These impediments have worsened during the past five years because policies have not been fully consistent with the objective of promoting increased international trade and investment.

Higher Levels of Competitiveness Needed to Achieve Vision 2020

To become a middle income country by 2020, Ghana's exports must grow at a minimum of 10% a year, doubling every seven years. But traditional exports, accounting for 85% of total exports, are projected to grow at most by 5% per annum. This means that non-traditional exports must be the new engine of growth, growing at more than 15% per year from now to 2020. This would increase their value from around $250 million in 1996 to almost $12 billion dollars in 2020. Furthermore, this growth must increasingly come from processing and manufacturing activities that add value to Ghana's indigenous resources and imported intermediate inputs. Ghana's competitiveness must improve dramatically to achieve export growth rates of this magnitude. This requires an unwavering commitment by government and the private sector to improving international competitiveness.

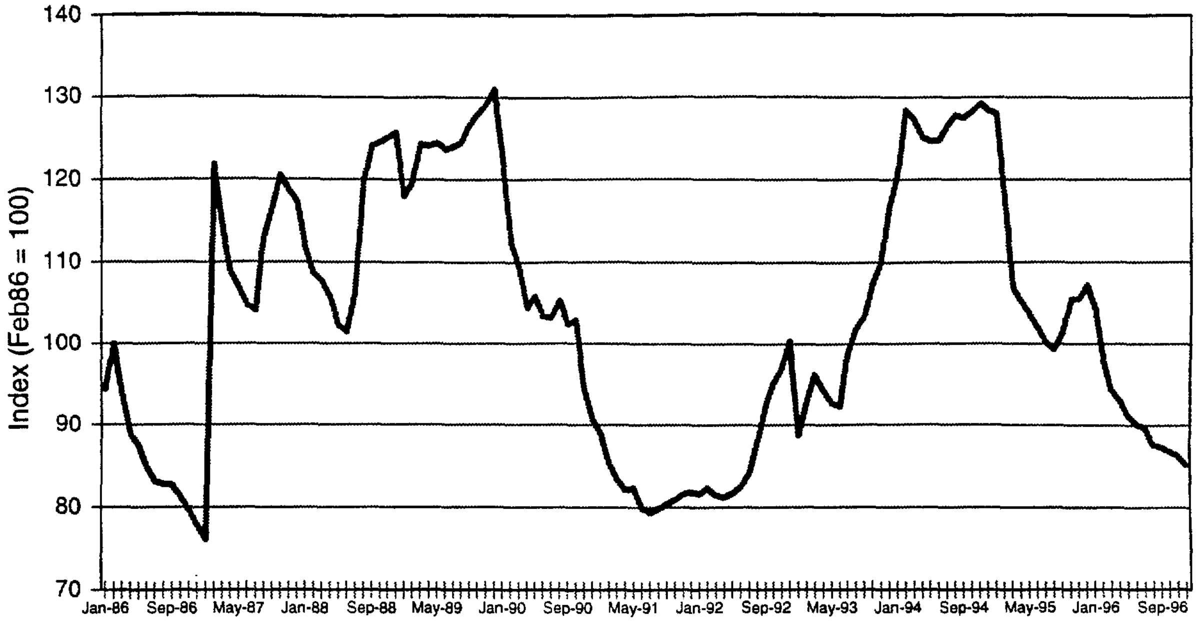
A key measure of Ghana's international competitiveness is the real return to export activities, as given by the exchange rate adjusted for the differences in inflation between Ghana and its trading partners. Over the 1986-1996 period the real returns to exporting (and to producing import substitutes) have fluctuated wildly (**see Figure 1**). There have been swings both up and down of 30%-40%, often occurring over relatively short periods of time. This variability in real returns has made exporting a high risk activity and has discouraged investment and expansion of production in the export sector. For example, the decline in real returns from mid-1994 to late 1996 represents a 30% reduction in Cedi returns which is equivalent to approximately $80 million dollars in lost income each year. The $80 million reduction in returns to exporters reduces the profits available for reinvestment and is equivalent to almost 25% of average private sector investment in recent years. This variability was caused by periods of high inflation and government intervention in the foreign exchange market to attempt to repress inflation. The implicit taxation of exporting and import-competing activities resulting from intervention in the foreign exchange market has eroded some of the gains from earlier trade liberalization under the ERP.

In spite of what has been regarded as a pioneering effort of trade liberalization, Ghana's explicit trade policies maintain a bias against international competitiveness. The continued reliance on trade taxes as a source of government revenues and a cumbersome system for the administration of trade are examples of this bias. The trade regime still exhibits remnants of an earlier interventionist era. The administrative system uses selective quotas, exemptions, exonerations and outright bans to guide resources into or out of areas where bureaucrats believe value can be enhanced. These implicit and explicit trade distortions are detrimental to export-led growth, because they drive resources into non-competitive activities that are made artificially profitable by the implicit protection offered by the distortions. Ghana still needs a more neutral trade environment.

Table 1. Economy-Wide Symptoms of Policies That Impede International Competitiveness

Labor Market	Financial Markets	Trade Regime	Public Sector Balance	External Balance	Role of Government
• Emoluments double the wage rate • Tenure/end of service benefits cause labor to be fixed cost in formal sector • Work practices hamper productivity--skills and tasks are mismatched • Incentives perversely encourage informal microenterprises and prevent optimal firm size • Government is the wage setter • Government wage bill is one-third of current expenditures	• Dollar indexation of the economy • High nominal interest rates (even if negative in real terms) decapitalize borrower • Domestic savings rate one quarter of that required for Vision 2020 • Government sector is dominant and crowds out private sector • Banks hold bulk of their assets in public sector securities • No long-term lending: private sector firms must finance expansion out of earnings • Limited access to credit reduces financing for smaller higher risk businesses like non-traditional exporters • High apparent returns are returns to high risk and speculation in financial swings	• Use of exchange rate as nominal anchor appreciates cedi and reduces incentive to export • Wide and continuous fluctuation in real exchange rate make exporting high-risk • Currency appreciation reduces amount of resources available to exporters to finance expansion • Dispersion in tariff structure distorts incentives for exports and aggravates revenue problem • Continued reliance on exonerations promote rent-seeking rather than profit-making behavior • Explicit interventions in specific products through bans and quotas • Agriculture severely punished by trade regime • Cumbersome administration of customs and other inspection procedures discourage exports	• Use of narrow rather than broad budget in presentation confuses nature and sources of inflation • Government persistently grants large wage increases • Domestic debt service over one-fourth of current expenditure and growing • Increased use of non-tax revenues such as divestiture receipts to finance budget • Continuous budget deficits create need for forced borrowing from financial sector • Inflation taxes the informal sector severely • Inflation dollarizes the economy and severely hampers government's opportunities to manage economy • Public finance issues create perverse incentives for exchange rate appreciation	• Excessive reliance on foreign savings • Trade regime favors importing over exporting activities • Public sector expenditures allocate resources to non-tradables and reduce level of exports and stifle efficient import substitution • Reserves are misused to depress the cedi price of foreign exchange • Economy is susceptible to speculative attacks on the currency • Excessive reliance on trade taxes	• Lack of consensus on appropriate roles of government and private sector in implementing economic growth strategy • Inadequate fora for economy-wide and sectoral policy debate lead to fragmented case-by-case approaches to issues • Too many rules and regulations from past still on books: too many permissions still required • Lack of self-sustaining business organizations with advocacy capability • Still common attitude that Government knows what is best for private sector • Private sector looks to government to bail out firms and for other privileges

Figure 1: Real Returns to Exporting Relative to Real Domestic Cost



MACROECONOMIC INSTABILITY: The Fundamental Problem Hampering Competitiveness

Inflation drives the distortions in the financial, labor and exchange rate markets. Ghana suffers from chronic inflation (**Figure 2**). Over the past 26 years inflation has never reached single digit levels and it has exceeded 25% in 18 of those years. Inflation reduces Ghana's competitiveness by increasing uncertainty in the business environment and raising the costs of doing business. It is also a cruel tax on poor people who hold a greater proportion of their meager assets in currency while wealthier people have assets that appreciate in an inflationary environment or are denominated in other countries' currencies.

Ghana's chronic inflation is a monetary problem. Transitory factors, such as a poor harvest and a consequent rise in food prices, can appear to exacerbate inflation in any one year. However, it is the excessive growth in money that explains Ghana's long-term inflation (**Figure 3**). Myths about inflation in Ghana have prevented a focus on the monetary nature of the problem. One of the myths is that inflation in Ghana is caused by food shortages. However, the long-term inflation that Ghana has experienced can only be explained by excessive growth in money over the long-term. Transitory events, such as an occasional poor harvest, cannot explain two decades of chronic inflation. Furthermore, the argument that devaluations cause inflation does not hold. During the period 1974-1977 when the exchange rate was fixed at C/.1.15 to the dollar, inflation averaged 55% per year; from 1979-1982, the exchange rate was fixed at C/.2.75 to the dollar, and yet inflation averaged almost 61% per year. It was inflation in previous years that made the devaluations of 1978 and 1983 inevitable.

Figure 2. Ghana: Inflation, Wages, Money and Market Exchange Rates

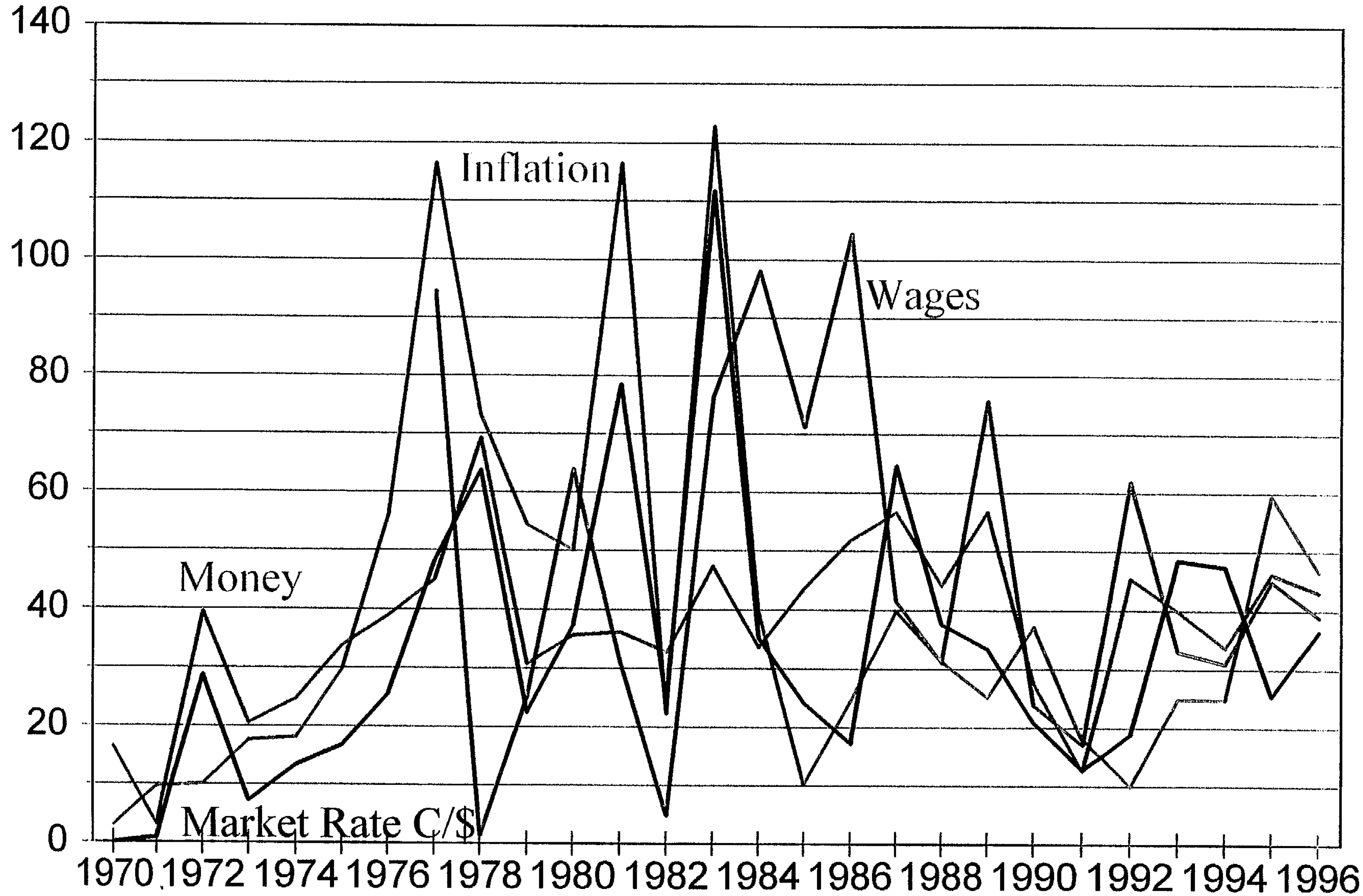
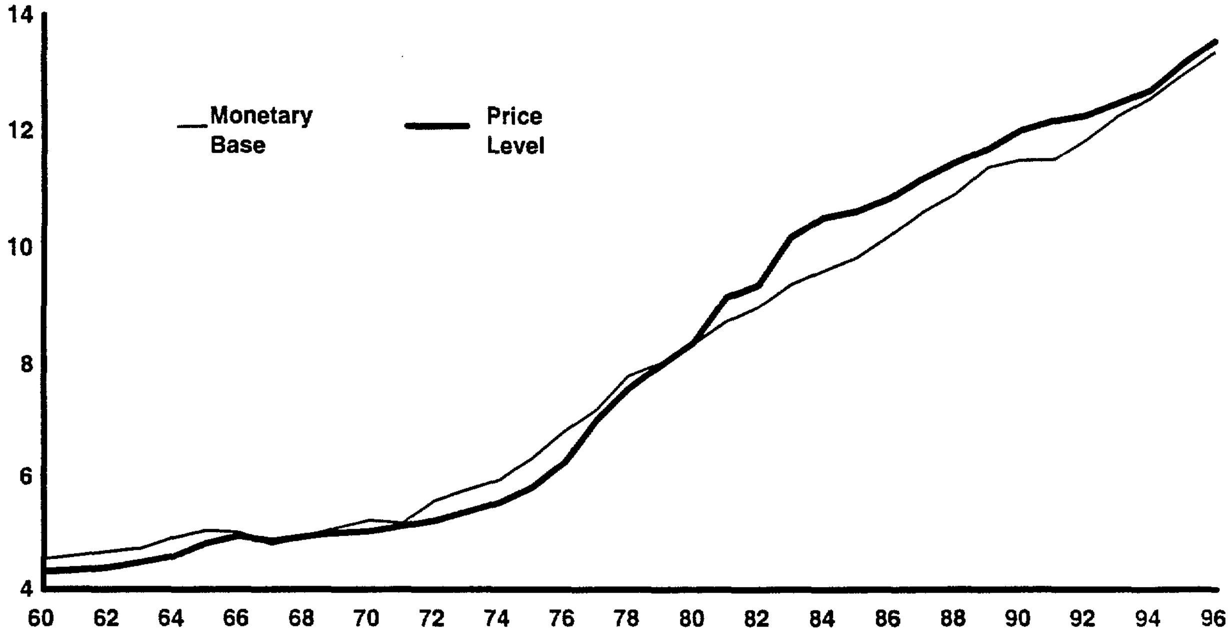


Figure 3. The Price Level and the Monetary Base



The monetary problem that drives Ghana's chronic inflation arises because government expenditures consistently exceed revenues, and the government has partially financed the resulting deficits by creating money (**Figure 4**). The reason for the deficit is the government's off-budget expenditures (**Figure 5**). These expenditures result from the way the government formulates and approves the budget. The narrow budget, as constructed by government and presented to Parliament for approval, excludes capital projects jointly financed by the government with donor project aid. Over the 1984-1995 period, the government had to contribute nearly $3 worth of cedis as counterpart funding for every dollar provided by the international donors. In the past, donor program resources (such as cash grants) were a principal source of these counterpart funds. Since the early 1990's, the mix of donor assistance shifted from program aid to project aid. This shift not only increased counterpart funding requirements, but also diminished the pool of funds traditionally used to meet those requirements. Government has subsequently used off-budget expenditures to provide the counterpart funding required by the donors' projects. The increased off-budget expenditures have exceeded the government's ability to finance them in a non-inflationary way. Parastatal deficits have also generated requirements for off-budget expenditures and these too have been financed through money creation.

The budget deficit is not a revenue problem. Government expenditures as a percent of GDP (more than 25%) are already too high in comparison with other countries at Ghana's stage of development. Increasing taxes to meet present expenditure levels will reduce competitiveness--the Government will be extracting funds from the private sector that could be used for productive investment. The challenge is to prioritize expenditures, concentrating on those items critically needed to sustain the legitimate roles of government in the economy.

Figure 4. Expenditures and Revenue

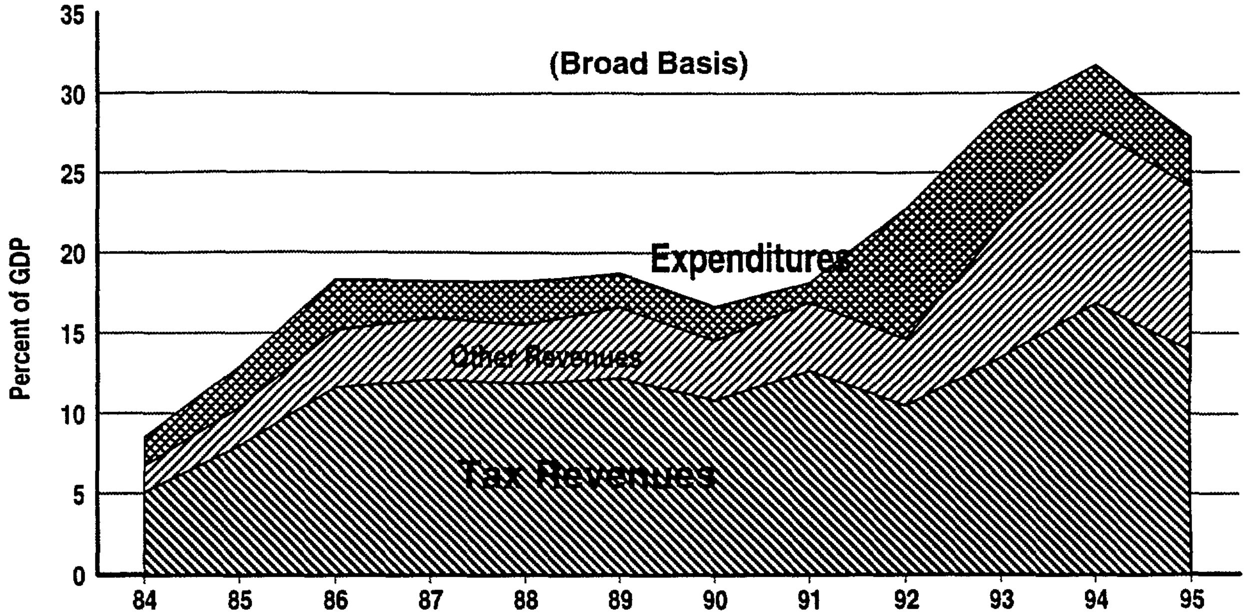
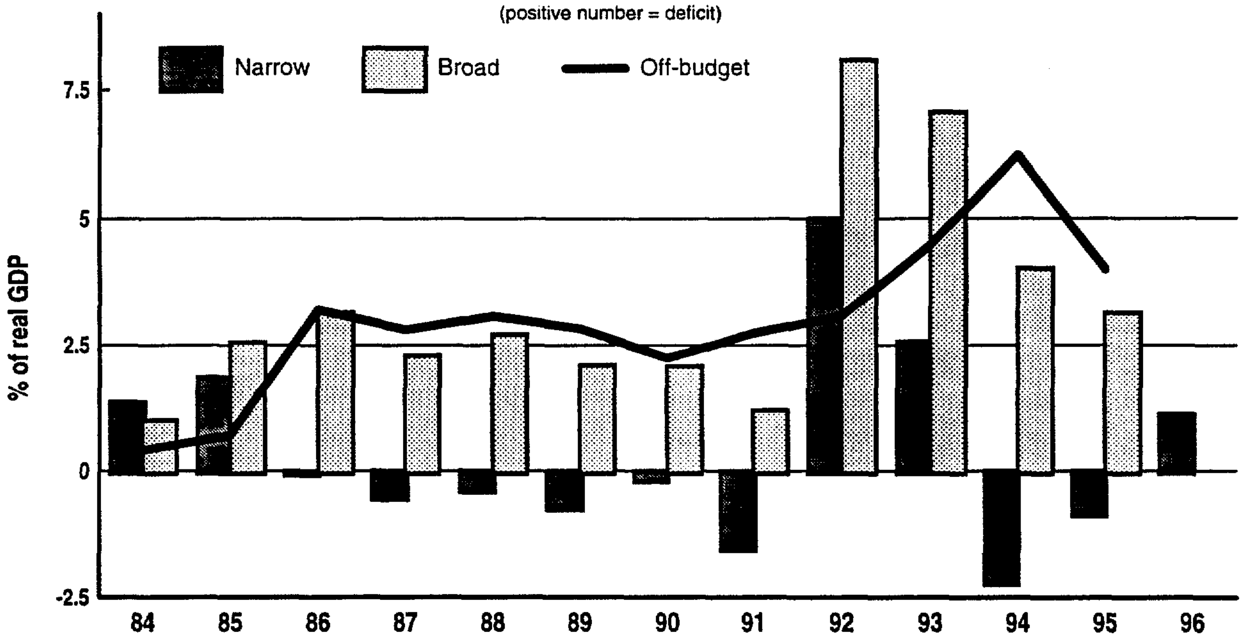


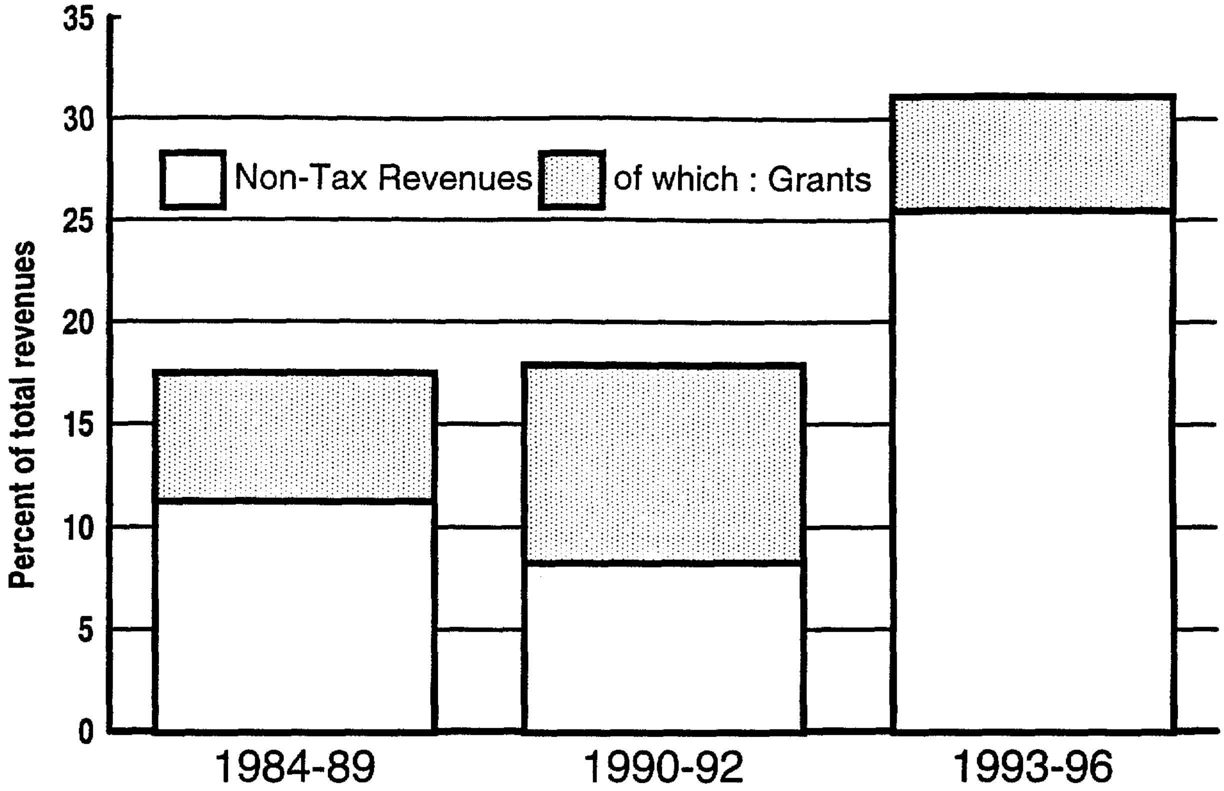
Figure 5. Off-Budget Expenditures and the Narrow and Broad Deficits

(positive number = deficit)



There is a revenue problem in Ghana. That problem is an increased reliance on extraordinary revenues as a share of total revenues (**Figure 6**). These temporary income windfalls include receipts from the divestiture of state owned enterprises and profits from the Bank of Ghana (BOG) that should not be considered revenues at all. Divestiture receipts are a one-off source of income because the government has a finite stock of assets that it can sell. Once the assets are gone, so is

Figure 6. Government Dependence on Extraordinary Revenues



this source of income. These receipts should therefore be "saved" by paying down debt. Using a windfall gain to meet permanent recurrent expenses, such as wages, is not the way to Vision 2020. Additionally, accounting gains accruing on the books of the Bank of Ghana do not represent real resources available to the government. For example, the C/.80 billion dividend paid by the Bank of Ghana to the Treasury in 1995 represented an accounting capital gain on the BOG's net foreign assets caused by exchange rate depreciation. It should have been used to off-set the massive debt that the Government assumed when the BOG sustained capital losses in the past due to exchange rate depreciation on its negative net foreign assets. Instead of reflecting an adjustment of accounting entries it was inappropriately monetized through the government's expenditures and, thus this source of extraordinary revenue added fuel to inflation.

The core inflationary problem is that, to finance the deficit the government borrows from the BOG and issues domestic debt. Borrowing from the BOG (e.g., through Ways and Means Advances) directly creates money. The government's demands on the BOG for financing, and the BOG's acquiescence in those demands, are the source of excess liquidity in the economy. The resulting growth in money has averaged 45% per year from 1992-1996--far in excess of the 4%-5% needed to support the real growth in the economy. Expansion of money has fueled inflation and created distortions in other markets as the government tried to adjust for the impact of the deficit (See below). The other form of borrowing the government has used to finance its deficits--issuing domestic debt-- has created a separate and increasingly serious problem. As a percentage of GDP, the domestic debt has more than doubled since 1990, growing from under 5% to more than 10%. The increase in domestic debt has resulted in a rapid growth in the share of recurrent expenditures needed to service the debt. In 1996, servicing the debt required 25% of the recurrent budget; up from 9% in 1990. Servicing the debt reduced the money available to fund the recurrent cost of other government services.

A major use of government's budgeted expenditures is its wage bill for pay and emoluments to civil servants. This item absorbs approximately 35% of the recurrent budget. With debt service rising to similar proportions, it will become increasingly difficult for the government to grant real wage increases for civil servants as a growing part of the budget goes toward funding the internal debt. Not only is government finance crowding out the private sector, it is crowding out the public sector as well.

Critical Events in Inflationary Finance of Recent Years

The complexity of macroeconomic management is illustrated by the following chronology of events during the last five years (1992-1997). By 1992, inflation appeared under control, yet policy choices and the reaction of economic agents to these choices ushered in a period in which inflation has been increasingly difficult to manage and the authorities have resorted to a series of ad-hoc manuevers in vain attempts to control inflation. The net effects of these have been deleterious to competitiveness and of minor benefit in the intended management of inflation. As each of these ad-hoc instruments is used, its subsequent value as a policy tool is eroded and the authorities are progressively losing instruments with which to manage the macro-economic variables in the economy. Sadly, the high degree of intervention in financial markets that results from the efforts to manage rather than erradicate inflation, serve to increase risks and costs throughout the economy. The major burden of these falls on the poor people of Ghana.

1992

During the five year period 1987-1991, the government's broad deficit averaged just over 2% of GDP, with a sharp fall off from 2.7% in 1988 to just 1.2% in 1991. While this did not represent a tight fiscal stance, the government was moving in the right direction. The falling deficits reduced financing needs, so inflation was also coming down from 40% in 1987 to 10% in 1992. This gradually improving situation suffered a severe setback during the latter half of 1992, when the government went on a spending spree in the run up to the election. Among other things, a large wage increase to the civil servants increased the wage bill 60% over that of the previous year. The resulting broad budget deficit exceeded 8% of GDP. It was financed with a Ways and Means Advance from the Bank of Ghana--out-and-out money creation. The resulting growth in the money supply of 45% was far in excess of the amount needed to support real economic growth of less than 4%. The excess money created had a small effect in 1992, because it occurred in the last quarter of the year. But the following year prices skyrocketed, with inflation reaching 25%.

1992-1993

A more immediate effect of the fiscal excesses was apparent in the movement of the nominal exchange rate: the Cedi began falling precipitously in the latter half of 1992 as people began converting cedis into dollars and imported goods to protect the value of their wealth in the face of a sharp rise in expected inflation. The Cedi continued to plunge in 1993 despite an attempt by the authorities to support the exchange rate by substantial sales of dollars into the foreign exchange market. People realized that this intervention was totally unsustainable and took advantage of the sale of cheap dollars to buy imports. Government actions thereby fueled a boom in the imports of consumer goods. The share of consumer goods in total imports soared to 37%, relative to its normal level of 20%; the dollar value of total imports in 1993 was up 19% over the previous year's value. The intervention was not only costly in terms of the misuse of scarce foreign exchange reserves but was also not sufficient to satisfy the demand; hence, the Cedi plunged by 48% in 1993.

1993-1994

The government ran another broad deficit equivalent to more than 7% of GDP in 1993 and this, together with the macroeconomic instability unleashed during 1992, set the stage for a second profound shock that further destablized the economy in 1994. This deficit was financed partly by money creation, thereby stoking inflationary expectations and the need for continued depreciation. The Cedi continued its free fall, begun in 1992 and continuing through 1993, depreciating by another 47% in 1994. This created serious problems for the Ghana National Petroleum Company (GNP) which was selling petrol at retail at a price in cedis that it was not allowed to raise--this price had been set by government at the beginning of the year under the assumption that the government would meet its macroeconomic targets in terms of money growth, inflation, depreciation, etc. The GNP was having to pay for its petroleum imports with dollars, so the unplanned for depreciation raised GNP's costs well above expectations, while its revenues remained fixed. The large resulting losses were financed by direct loans from the BOG, another instance of out-and-out money creation. High-powered money increased by more than a third. This huge monetary shock sent inflation to a new modern high of 60% per year in 1995.

1995

With inflation running at these rates, there was tremendous downward pressure on the Cedi. Unfortunately, the government chose to intervene in the foreign exchange market with increased dollar sales to repress depreciation directly. As a result, the Cedi depreciated by only 25% in a year when inflation was 60%. Because dollars became cheaper, the prices of imports and exports were repressed in real terms. This constituted a real disincentive to producing exports and import substitutes.

1996

In some ways, 1996--an election year--was a reprise of 1992. Government spending excesses led to a deficit even in the narrow budget. Inflation "fell" to 46%, partly because the government continued its policy of using scarce foreign exchange reserves to intervene in the market to repress depreciation. This mopped up some cedis and repressed the rate of increase in the prices of tradable goods, thereby creating the illusion that inflation fell. But this was a very expensive illusion to create and maintain: competitiveness, as measured by the real exchange rate, took a very big hit. Exporters suffered profit squeezes. Producers of import substitutes found that imported goods were a lot cheaper than what they could produce.

The government also employed its traditional mopping up operations as well, i.e., sales of BOG securities. Despite these interventions in the foreign exchange and domestic bond markets, the money supply increased by 43% in 1996. This represented a tremendous injection of liquidity and did not augur well for the inflation outlook in 1997.

1997

The recent fall in inflation to 29% as of March 1997 is not a sign that the economy is becoming more stable. Going from 70.8% to 29.2% was accomplished by treating the symptoms rather than the causes. Inflation is a serious problem and will remain so as long as only its symptoms are treated. Growth of 5% may be sustainable indefinitely, but with donors less willing to give grants and with donor projects demanding more local counterpart funds, Ghana may be reaching the limits of its ability to obtain concessionaire financing from the rest of the world. Even if the donors are willing, this is not the way to achieve Vision 2020.

The tools used for BOG mopping up exercises are contradictory to Vision 2020. The use of the exchange rate as an anchor against inflation means that the export sector gets hit on the cost side and on the profit side thus reducing international competitiveness. Mopping up operations through sales of BOG securities have also been increasing. This requires the financial system to take on more debt and reduces funding for private sector growth. Moreover the financial system is going to demand a higher premium to do that in the form of higher interest rates, which further raises costs to the private sector. In the future, there is a risk that the monetary authorities could lose control of this process and that a hyperinflation could result.

DYSFUNCTIONAL FINANCIAL MARKETS

Financial market performance determines the allocation of domestic resources to consumption and investment and the government's participation in the financial market determines the allocation of these two between the public and private sector. A low savings rate and high government participation together cause lower labor productivity and are fundamental causes for Ghana being a high-cost economy. Vision 2020 requires an investment at the rate of about one-quarter of GDP. This investment must come from either domestic or foreign savings. Currently, the average domestic savings rate is very low (6% of GDP). One reason is the negative savings of the public sector. Ghana thus relies on foreign savings to finance investment.

At present, most of the foreign savings are in the form of loans to the public sector. Ghana has not yet made the policy changes to justify increased long-term portfolio investment. Investors look at political stability and economic viability when deciding to invest in a country. Ghana's political stability is a plus but the economic viability is questionable. As a result of the macroeconomic instability that has characterized the economy for the past several years, the capital that Ghana is attracting today tends to be short-term money. For instance, over the last six months buying Treasury Bills would have ~~yielded 30% after~~ depreciation. However, this money will quickly move to other countries if better returns are available. The principal concerns about the present investment environment include an undisciplined monetary policy; an inefficient regulatory system; an ineffective legal system; a low savings rate; and a detrimental climate for small business development. The risk/return relationship among investment alternatives is perverse. It should be that the greater the risk, the greater the return; but in Ghana, the greater the risk one takes, the lower the return one receives.

If Ghana is to increase its domestic savings rate, major changes will be required in the financial sector. The public sector dominates financial markets today. Financial institutions are used primarily to finance Government deficits, not private sector growth. Banks hold the bulk of their assets in securities issued by the public sector. Reserve requirements on bank deposits, set by Government, enable it to finance its deficit and discriminate against the private sector. Moreover, high nominal interest rates in excess of 45% for risk-free government securities make lending to the private sector unattractive for the banks. Since 1991, the share of credit going to the public sector has increased from 40% to over 60%. The limited credit to the private sector is short-term and rationed to larger preferred clients. Thus, potential growth sectors such as non-traditional exports have trouble obtaining financing because firms are typically smaller and higher risk. In the present dysfunctional financial system, no long-term financing is available and firms must grow by reinvesting profits. But profits have been repressed as a consequence of the government intervention in the foreign exchange market. This limits firm growth and Ghana's competitiveness.

New financial instruments need to be part of financial sector development. Investors noted that instruments can be developed that hedge or exploit risks but they will not reduce the risks inherent in Ghana's present macroeconomic and financial system. Those risks can only be addressed through: 1) a more independent Bank of Ghana that will manage the monetary system effectively and combat fiscal imbalances; 2) a transparent system of formulating and prioritizing fiscal policies; 3) an enhanced regulatory environment for the financial sector; 4) a strengthened Ghana Stock Exchange that increases the number of listings and products; and 5) an enhanced government securities market.

LABOR MARKETS

Labor productivity is the principal determinant of an economy's ability to compete in global markets because labor is the principal means of converting Ghana's resources into goods and services with international value. In Ghana, as in all economies, the labor market always bears the burden of any and all distortions in the policy framework. The most notable symptoms of these distortions are low labor productivity and a labor market characterized by a huge informal sector.

Labor in Ghana is costly, in spite of low wages, because of low labor productivity. Low productivity results from inadequate investment and from labor practices. The government's domination of financial markets has reduced the supply and raised the cost of financing to the private sector. This has restricted investment in modern technologies and inputs that could have raised labor productivity.

Labor is also costly because the labor market is rigid as a result of work practices, tenure rules, and emoluments that cause severe mismatching of skills to tasks. End-of-service benefits and other emoluments can effectively double wage rates. Tenure rules and end-of-service benefits cause labor to be a fixed cost in the formal sector. Such conditions are the driving force for informality in the labor market. Trade and exchange rate policies, in addition to creating an anti-export bias, have adversely affected employment growth. They have reduced employment opportunities in the export sector. Consequently labor has had to seek less remunerative opportunities in the informal sector.

Paradoxically, the labor market also bears the deleterious consequences of the government's well-intentioned efforts to provide public services and to maintain the incomes of public servants. For example, the government's wage setting behavior in the formal sector puts upward pressure on wages in the rest of the economy. This is directly detrimental to competitiveness. Increases in public sector wages also increase the government's financing needs, which are partly met by issuing domestic debt. This raises debt servicing needs which, as a growing share of recurrent expenditures, crowds out the government's ability to maintain wages for public servants and to provide basic services to the population. The resulting poor health and educational conditions are further detriments to competitiveness.

PUSH-PULL: A STRATEGY TO RE-ENERGIZE THE PRIVATE SECTOR

For Ghana to reach the next level of performance, it must harness the energy of micro enterprises in the informal sector. Widespread informality is one result of the dysfunctional labor and financial markets. The Ghanaian labor market is primarily an informal one in which human effort is encumbered by low levels of technology and inadequate availability of capital. The extent of informality is clear from the structure of the labor market. Rural informal employment provides the majority of the jobs, 62%. The other 38% is divided between the formal and urban informal sector. While Government dominates the formal sector, trade is the chief occupation in the urban informal sector. Two-thirds of employment in the urban informal sector is in trade and 1.0 million of the 1.3 million engaged in trade are women entrepreneurs.

While dysfunctional labor and financial markets reduce access to employment and finance in the formal sector, the numerous laws, regulations and restrictions, imposed on formal sector businesses have had an important role in the creation of the large informal sector in Ghana today. Informal sector firms are often able to avoid the transaction cost consequences of these regulations, or pay a smaller "informal" tax to avoid them. Another advantage of the informal sector is its ability to deal adeptly to changing circumstances.

The informal sector plays an important role in Ghana today, offering employment opportunities for tens of thousands of people and income support for thousands more. Moreover, the informal sector provides a significant contribution to the national economy in the form of the goods and services it provides. However, a widespread informal sector is a symbol of market failure. While it has created thousands of jobs, the informal sector serves as a reservoir of low wage, low productivity labor. If the informal sector is to become more "formalized", the present rules, regulations and market imperfections leading to informality must be addressed. Addressing these issues is a necessary but not sufficient step to help firms become more integrated into the national economy. A more active strategy is needed.

One concept advanced to assist in this process is that of Push-Pull. The Push-Pull strategy exploits the backward and forward linkages within and between sectors. For example, the government and donors provide facilities and services that enable established non-traditional exporters to enter a new market, to expand market share in an existing one, or to become more efficient and competitive. This is the "push" part of the strategy. As export firms expand their production, they will need additional inputs and services. This will provide opportunities for smaller suppliers to expand their output to provide these inputs and services. Growth in the larger firms "pulls" smaller firms along through mutually beneficial contractual relationships.

This strategy is already being employed by some firms. For example, a large pineapple exporter unable to expand production because of land or labor constraints may turn to smaller neighboring producers to provide additional production. The larger exporter may function as a buyer/assembler, or provide credit or inputs to the out growers, or help them to arrange credit through local banks. All of these functions help the smaller producers to gain access to markets or inputs they would not otherwise be able to access. Push-pull not only helps the small producer but may also encourage the larger producer to specialize in the assembly and export function, simultaneously improving efficiency and competitiveness. Push-pull to work effectively must be based on the principal that the linkages created are mutually advantageous. While there are instances where these linkages will occur spontaneously, there is the need to examine the feasibility of providing fiscal or other incentives that would accelerate the process.

Given present conditions in Ghanaian financial markets, push-pull can also be used to encourage banks to look at the small and microenterprise sector by linking them with larger partners in developing loan requests. Present bank rules and procedures limit the availability of credit to microenterprises. This pooling of risk can be helpful to encourage the development and strengthening of financial institutions to lend directly to microenterprises.

DIFFICULT CHOICES

Ghana must make difficult choices now if it is to achieve Vision 2020. The Government has an opportunity to use the upcoming economic summit to develop a national consensus for making the difficult decisions that will make international competitiveness the central policy theme. Government must view this as an opportunity to reinvigorate the reform process. Reforms are needed in many areas -- not just in one or two.

Reducing inflation to single digit levels permanently is central to the success of any program. This will diminish pressure for large wage increases. It will enable financial markets to finance private sector growth rather than financing government deficits. A permanently lower level of inflation will reduce the temptation -- and the need -- to use the exchange rate as an anchor against inflation. The exchange rate will then provide price signals to exporters and importers that are consistent with the goals of Vision 2020.

Balancing the government's budget is the only way to permanently reduce inflation to single digit levels. Budgetary balance would eliminate the temptation of printing money to finance a deficit. Balancing the budget must focus on expenditure reduction -- not increasing tax revenues. Tax revenues currently represent 14% GDP. Balancing the budget by increasing tax revenues to 25%-30% of GDP implies a massive transfer of income from the private sector to the public sector and would further damage Ghana's competitiveness. Such a transfer is inconsistent with the goals of Vision 2020.

The unavoidable necessity of reducing expenditures is at the core of the difficult choices that must be made. The decisions about which government activities will be scaled down or eliminated require a consensus that will be possible only if all proposed expenditures, especially those that to date have been off the budget, are able to be debated by the stakeholders. For a start this means that the government should start reporting its budget using the "broad" definition and that the broad budget be submitted to Parliament for approval. In the context of Vision 2020, the traditional narrow budget is not only irrelevant, but also misleading--substantial Government outlays are obligated for projects in agreements between the Executive branch of government and donor institutions, with no public debate about the merits of the projects.

The fiscal discipline necessary for Vision 2020 requires a Bank of Ghana that is considerably freer of political pressures than it is today. The Bank of Ghana needs new enabling legislation to make it more independent. In particular, the BOG should no longer be required to make Ways and Means Advances to the Government or to finance parastatal losses. This independence would not guarantee fiscal balance, but it would eliminate the likelihood that the Government could resort to printing money in the event of a large fiscal deficit.

Increased domestic savings and financial sector reform are essential for growth. Vision 2020 requires domestic savings increasing from the present 6% to 18-20% of GDP. This will require a macroeconomic environment with low inflation that encourages savings and lower interest rates, as well as, a balanced or near balanced fiscal budget that will reduce government competition with the private sector for available credit. However, continued regulatory changes and institutional strengthening will also be required for the financial sector. Likewise, social security system changes in other countries that have spurred increased domestic savings need to be investigated and adopted where sensible.

Labor market flexibility is necessary for competitiveness. Real wage flexibility is important for increased competitiveness. If wages are sustained at artificially high levels by labor market rigidities, then international competitiveness can only be increased by productivity growth. Growth in productivity requires that firms have access to capital needed for new technology and inputs, a function of financial market reform. The labor market needs a high degree of flexibility and the development of incentives to provide demand driven skill training by the private sector.

The informal sector must be formalized. Labor, financial and regulatory policies that create informality must be identified and resolved by providing improved access to markets, technology and capital. The push-pull concept should be explored to link formal and informal sector firms.

The cornerstone of an export-led growth strategy is the maintenance of a competitive exchange rate. Countries that have tried this in the absence of appropriate and consistent fiscal and monetary policies inevitably fail to control inflation, waste millions of dollars in foreign exchange in the attempt, and do serious damage to their export sector. The commitment to export-led growth is a long-term commitment. Many countries that have tried it have initially been successful, but then diverted their efforts to other issues and other strategies, thinking that they had done enough. These diversions often meant the failure of the outward-oriented growth strategies. In turn, this means that Ghana cannot use the exchange rate as an instrument to control inflation, and must be willing to make a long-term commitment to export-led growth.

ELEMENTS OF A STRATEGY FOR REACHING THE NEXT LEVEL OF INTERNATIONAL COMPETITIVENESS

The Ghanaian Delegates to the North Carolina Conference agreed on the following principles as elements of a strategy for rapid economic growth and the achievement of Vision 2020:

- The conference recognized that in Ghana inflation is a monetary phenomenon that arises primarily from the government's expenditures in excess of receipts. The clear conclusion was that the broad budget of government must be financed in non-inflationary manners, primarily from recurring revenues. There was not a consensus on the revenue side, and some called for increasing revenues, along with reductions in expenditures. Others, including the resource persons, pointed out that Ghana's government already absorbs too large a share of the economy for its stage of development, and that increasing revenue collections will further erode the ability of the private firms to compete in world markets.

- There was a clear consensus on the need for expenditure control, and rigor in using non-inflationary means of financing the government. In this vein, some expressed concern that external funding of government projects be carefully reviewed for their inflationary risks.

- In keeping with the foregoing, the conferees recommended that the budget and its financing mechanisms be vetted in advance of the budget year with guaranteed adherence unless legislative approval is granted for exceptions. The exchange rate should not be used as an anchor for the economy, but rather strict monetary targets should be set and fulfilled. Interventions in the foreign exchange market add costs and risks to all private enterprise activities.

- All sectors, including government, should strive for efficiency in their revenue generating and taxation role. Aside from the lack of consensus on the need for increased revenues, there was recognition that a broader tax base would be consistent with increased international competitiveness. The prices of publicly provided goods and services, such as petrol and energy, should be priced to ensure full cost recovery under efficient delivery systems. This will promote competitiveness by reducing the risk of off-budget expenditures, stimulating the efficient use of scarce resources, and improving the availability and reliability of public services. Accordingly, wages should be tied to labor productivity.

The conference forged an effective public-private partnership for achieving the social, economic and political goals inherent in Vision 2020. The partnership calls for agreement on goals and open debate on the means needed to achieve these. The consultation between the partners will be frequent, informed, respectful, candid, polite, and inclusive. All constituencies are welcome to participate in the consultations, and all consultations will be open to all. The first consultation is to convene a summit for national economic consensus as soon as possible. The mandate of the first National Summit will be to address pressing economic issues that affect private sector performance and the performance of the national economy as a whole. The Private Enterprise Foundation was designated as the convener of the summit and the President of the Republic as the leader of the summit.