An Action Plan for Implementing Foreign Exchange Liberalization Policies in Ghana

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Sigma One Corporation

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An Action Plan for Implementing Foreign Exchange Liberalization Policies in Ghana

1 Introduction

1.1 The issue of liberalizing exchange restrictions on international transactions poses serious challenges for Ghana, almost as serious as the difficulties the country faces goals if it does not sustain the processes of policy reform and further liberalization. For without continued policy reform and liberalization, not only will Ghana find it very hard to achieve the rates of growth needed for attainment of its Vision 2020 objectives, it will run the risk of sliding backwards and falling further and further behind those developing countries that are successfully reforming themselves and becoming more internationally competitive. This paper serves to review the issues regarding further liberalization of the remaining exchange control restrictions, mainly on the capital account, weighing the costs and benefits of the existing exchange control regime versus a more liberalized environment, and proposing an action plan for further steps along the path of exchange control liberalization.

1.2 In principle, by attaining IMF Article VIII Status, Ghana has removed all exchange control restrictions on current account transactions (IMF, 1998). Thus, the remaining key issues concern the extent of exchange controls on capital flows. These flows involve foreign direct investment, portfolio investment and other investment (e.g., institutional loans and trade credit between unrelated firms) by residents and non-residents.

1.3 Numerous reasons can be put forward for adopting exchange controls on capital flows, such as they insulate monetary policy from capital inflows and shallow capital markets, or they 'trap' domestic savings inside the country helping to ensure funding is available for investment, or they enable monetary authorities to raise interest rates to halt rapid credit growth and inflationary pressures (Mabe, 1996; Phaleng, 1994).

1.4 Historically, the tightening of Ghana's exchange controls on both current and capital account transactions arose in the early 1960s in response to the accelerating decline in foreign exchange reserves caused by a rapidly expanding government expenditure programme in the face of sluggish growth in fiscal revenues and export receipts. The government resorted to import licensing and exchange controls not only to protect the balance of payments, but also to promote import substitution, industrialisation and geographic diversification of trade towards Eastern bloc countries. However, because of the fiscal imbalance and the overvalued exchange rate at the time, the excess demand for foreign exchange made rents from securing import licenses high, which induced widespread corruption in licensing (Leith, 1996).

1.5 Eventually, the system of import licensing and exchange controls resulted in the excess demand in the economy being vented through inflation, which, with a fixed exchange rate, made the export sector less competitive, further aggravating the balance of payments disequilibrium.

1.6 The record of exchange control implementation in Ghana, as elsewhere, was not particularly successful, with the inherent inefficiencies in such controls being compounded by rent-seeking, corruption and other distortions. While the policy makers believed the net costs associated with a regime of unrestricted current and capital transactions exceeded the net costs the system of exchange controls that were established, the experience of the 1970s and early 1980s eventually gave rise to a consensus to the contrary.

1.7 For many businesses, households, members of the labour force and the national economy more generally, exchange controls on both the current account and the capital account proved to be quite costly. They undermined economic policy discipline by delaying reforms and needed macroeconomic adjustments (Mehran et al, 1998). Beyond that, they raised the cost of doing business in Ghana. They also entailed substantial costs of enforcement, as well as evasion; and they encouraged unproductive rent-seeking behaviour and corruption (Leith and Lofchie, 1993). That record provided ample reasons for exchange control reform, which led to substantial relaxation of exchange control restrictions, especially on current account transactions, culminating in attainment of IMF Article VIII Status in 1994. But, as noted later in this paper, areas of concern regarding capital account liberalization still remain to be seriously addressed. And, until they are, it will be difficult for the authorities to develop the appropriate strategies needed for further liberalization of the capital account, e.g., getting the proper sequencing of reforms in place, that would allow for a gradual and orderly process of liberalization or a big bang approach, if that would be best.

1.8 This paper explores in Section 2 the various reasons for exchange control reform, followed by a discussion of the broad areas of concern regarding liberalization of exchange controls on capital account transactions in Section 3. Section 4 then attempts to address those areas of concern broadly, while Section 5 considers how Ghana fares in meeting those concerns. Section 6 then sets out strategies for exchange control liberalization that take into account those areas of concern. Section 7 concludes with some recommendations to facilitate continuing the processes of policy reform. Appendix 1 provides a brief summary of the current exchange restrictions in force. Appendix 2 considers the various reasons and rationales that have been used over the years for imposing exchange control on international transactions. Appendix 3 considers the record of exchange control implementation, while the costs and benefits of exchange control regimes and exchange control liberalization are then considered in Appendix 4.

2 Reasons for Exchange Control Reform

2.1 Over the past twenty years, many countries have come to recognise that restrictive and cumbersome exchange control procedures do not contribute to creating the allocative efficiency required to create a vibrant and resilient economy. Rather, exchange controls were seen to be ultimately responsible for low and negative growth; they provided the justification for the imposition of complex administrative arrangements for allocating limited foreign exchange resources; and they led to a highly distorted incentive framework.

2.2 Adopting a strategy of exchange control liberalization will signal that the authorities are committed to ensuring they will have in place the requisite policies so that exchange control liberalization can be sustained (Jefferis and Harvey, 1995). One of those prerequisites for exchange control liberalization is a credible and consistent policy framework to achieve macroeconomic stability; e.g., fiscal balance and no 'crowding out' of the private sector, or a sound and sustainable fiscal expenditure programme. That macroeconomic policy framework should include having the ability to cope with internal or external shocks to which the economy might be prone, with contingency plans and the capacity and willingness to implement them (Bank of Botswana, 1996).

2.3 A commitment to a policy of a stable, competitive real exchange rate is another key prerequisite for exchange control liberalization (Jefferis, 1997). Moreover, the authorities need to have a credible financial sector policy which ensures the development of a safe and sound financial system with attractive modern financial techniques and instruments, including providing for appropriate measures to deal with money laundering and related fraudulent practices (Mehran et al, 1998). A further prerequisite for exchange control liberalization is a labour market system without restrictions and impediments that inhibit wage and/or price flexibility that can boost economic efficiency. Finally, the underlying framework needs to establish appropriate tax policies for an exchange control free environment (Eichengreen et al, 1998).

2.4 There was a general recognition in most countries that capital account controls had been ineffective in controlling outflows or in protecting the balance of payments, while at the same time they usually discouraged capital inflows, thus aggravating balance of payments problems (Mohohlo, 1996). The authorities recognised that capital mobility does increase with time; thus exchange controls are inherently of limited effectiveness, at best in the short run, and are more likely than not to be harmful in the long run. The evidence from around the world indicated that capital will flow to, and stay in, countries with sound and sustainable macroeconomic policies, while it will flow from countries showing signs, whether real or just perceived, of major macroeconomic instability, whether that instability is caused by endogenous or exogenous shocks, or bad policies (Bank of Botswana, 1996). This latter point may be especially important in countries which do not produce and disseminate reliable statistics on a timely basis: the lack of information spawns uncertainty, rumours of instability and destabilising speculative behaviour.

2.5 The desire for increased globalization and integration by many countries also led them to adopt reforms aimed at exchange control liberalization, especially of the capital account. They recognised that any country that does not liberalise will be left further and further behind in the race for development and improved standards of living, and will be increasingly marginalised in terms of attracting foreign direct investment needed to spur economic growth (Mathieson et al, 1993).

2.6 Furthermore, there was widespread acknowledgement that exchange controls had become a futile exercise in the context of an increasingly open and integrated financial environment. It became increasingly accepted that liberalization of the capital account, consistent with development of sound domestic financial markets and institutions, could significantly improve the functioning of the country's financial system in terms of efficiency gains, productivity improvements and innovations in financial products and services (Mabe, 1996).

2.7 The bottom line is reflected in the record that, in almost all the countries that have liberalized exchange control regimes, they continue to seek to preserve and develop a liberalized environment: like Moses and the Children of Israel, having struggled through the desert for 40 years to reach the promised land, they do not want to go back to the Egypt of financial repression and non-market systems of resource allocation. Similarly, countries that have temporarily lost access to international capital markets, actively seek to regain it (e.g., Chile and Malaysia, which temporarily reintroduced exchange controls, were quick to remove them.). And most countries that never had a liberalized capital account, seek to achieve it. Even those countries with some bitter exchange control liberalization experience (e.g., Mexico, Thailand and Korea), do not want to go back to repressive exchange control regimes; they want to find out how to avoid such problems in the future, while benefiting from increased capital flows (Mathieson et al, 1993).

3 Areas of Concern

3.1 Notwithstanding the case for reform of capital account controls, there are a number of areas of concern that need to be addressed in any programme for exchange control liberalization. These are briefly listed below, and discussed more fully in the next section.

- Concern that exchange control liberalization could lead to capital outflows that could destabilise the economy.
- Fear that authorities will be unable to react quickly enough to changes in international financial conditions or to large gross capital flows.
- Concern about speculative asset price bubbles that could arise from rapid and large capital inflows.
- Concern about risks to financial sector soundness because incentives are distorted and domestic regulation and supervision are inadequate.
- Concern that sizable capital inflows could lead to an appreciation of the real exchange rate, which could erode international competitiveness, being especially harmful to the export sector, but also to producers of import substitutes.
- Concern about loss of ability to have an independent monetary policy.
- Concern about possible loss of tax revenue.
- Concern over effects on local industries protected by exchange controls.
- Concerns about becoming a conduit for capital flight from neighbouring less liberalized regimes, and/or a venue for illegal money laundering.
- Concern about the shift of the nation's foreign exchange reserves from government hands to private sector hands.

- Concern about loss of reliable statistics for balance of payments and national accounts.

4 Addressing the Concerns

4.1 All of the above concerns can and should be addressed in building the consensus needed for successful policy reform. The relaxation and/or removal of capital account exchange controls provides a strong signal about how government will treat investors; and this can have substantial impact on the level and types of capital flows a country experiences (Jefferis, 1997). The removal of exchange controls on the capital account signals that government is committed to creating and maintaining an investor friendly investment climate. But, to credibly back up such a commitment, government must establish, as prerequisites, a sound and sustainable macroeconomic policy framework, as well as an effective financial market regulatory authority and the systems necessary to provide prudential oversight on money and capital market transactions.

Destabilising Capital Outflows

4.2 Because the authorities in many countries adopted exchange controls in order to regulate the outflow of capital and prevent the loss of scarce foreign exchange, they need to be satisfied that exchange control liberalization will not lead to capital outflows that could destabilise their economies. In that regard, a key ingredient for successful exchange control liberalization is to have in place an appropriate macroeconomic policy framework that is credible, transparent, stable and resilient, that would not only provide positive incentives for capital to remain in the country, but would also limit contagion effects of external shocks to the economy that might arise from time to time (Williamson and Lessard, 1987). Such a framework would, for example, ensure that an adverse terms of trade shock would not lead to banking system distress or crises by assuring that the financial system is well-supervised and that appropriate safeguards and safety nets are in place (Jefferis, 1997). The economy must be managed to allow for the adjustment to exogenous shocks. In the event of a severe shock requiring the introduction of short term controls on foreign transactions, the imposition of such controls must be for a short term, to be removed as soon as practicable.

Inability to React Quickly Enough

4.3 More importantly, some monetary authorities resist exchange control liberalization because they are afraid that they will be unable to react quickly enough to changes in international financial conditions or to large gross capital flows, and thus unable to cope with the shocks to the financial system or the foreign exchange market or the political repercussions that might arise from a liberalized system.

4.4 Sterilisation, fiscal policy and exchange rate policy are the three main instruments available to the authorities to manage capital inflows in a liberalized environment (Mohohlo, 1999). In the process of exchange control liberalization, it is generally important that the monetary authorities' ability to manage capital flows and initiate policy actions timeously be strengthened. In some countries, e.g., Chile and Malaysia, the authorities have introduced special, short term measures to manage potentially volatile capital flows, such as marginal reserve requirements and taxes on capital flows. However, selective capital account controls, such as a requirement that 30 percent of all inflows be deposited without interest in central bank for one year, or that stamp duties be imposed on contract notes relating to sales of securities, may lead to high interest rates and segmented financial markets, as well as to activities to circumvent the controls (Mohohlo, 1999).

Speculative Asset Price Bubbles

4.5 Included in this area of concern is the problem that the authorities might have with speculative asset price bubbles that could arise from rapid and large capital inflows. Forestalling such bubbles has proved difficult in some liberalized economies; but this may be due to inertia on the part of policy makers, rather than "excessive exuberance" on the part of market participants. Thus, the authorities need to be ready and able to prick such bubbles before they become excessive (Bank of Botswana, 1996).

Risks to Financial Sector Soundness

4.6 Another area of concern involves the risks to financial sector soundness that might arise when incentives within the financial system are distorted and domestic regulation and supervision are inadequate. In such an environment, there could be a possible sharp deterioration in the quality of bank loan portfolios as a result of volatile exchange rates. Such banking system crises are often difficult to predict due to the lack of appropriate indicators and information. But the lesson that has been learned from past episodes is that responses to financial crises should be swift, clear and substantial in order to restore both stability and investor confidence (Montiel).

4.7 Prudent regulation and diligent supervision of the financial sector is an indispensable complement to the sound macroeconomic policy framework (Edwards, 1984, Hanson, 1992). One of the recurring lessons that have been learned in recent years is that the banking system needs to be sound, highly liquid and solvent, with the problems of weaker banks resolved before their failure could trigger a run on other banks. Poorly regulated and supervised financial institutions, which neither had good risk assessment and management systems nor had made adequate provisions for the credit, market and currency risks to which they were exposed, should not be permitted to intermediate large capital flows (Montiel, 1998).

4.8 Strict prudential regulation is crucial in banking systems where auditing and accounting practices are sub-standard and risk management is weak, if the central bank provides a safety net to backstop financial markets. Not only must appropriate regulatory guidelines be in place, the supervisory authority must ensure they are transparently and vigorously enforced (Hanson, 1992).

4.9 Alternative sequencing of capital account liberalization is possible depending upon the state of the existing institutional structures, legal systems and business practices, and how well the monetary authorities' are equipped to manage change (McKinnon, 1982). Often, foreign ownership and/or participation in the banking system has been found to bring important economic benefits in the process of exchange control liberalization through improved productivity via technology transfer and more efficient management practices. However, before removing most restrictions on capital account transactions, major problems in the financial system must be adequately addressed (Edwards, 1984). Insolvent financial institutions or their susceptibility to insolvency should be rectified before steps are taken to liberalize the banking system or open it up fully to international capital inflows (Williamson, 1991).

4.10 The markets for domestic equities and debt instruments and their supporting infrastructure must be well-developed, with substantial numbers and volumes of listed securities that are actively traded in an efficient, well-supervised environment, before they are opened to liberalized capital flows. In the absence of such an environment, large capital flows could lead to instability and greater uncertainty, which could deter productive investment and the efficiency gains capital account liberalization would seek to foster (Bank of Botswana, 1998).

4.11 Because major international capital markets are already well-developed and well-supervised, with diverse opportunities for investors, risk hedgers and speculators, capital outflows to such markets are not a major concern (Montiel, 1998). Rather, the key concern is that existing restrictions may be providing some support for either a significant domestic macroeconomic disequilibrium or a highly distorted financial system. An exchange rate that is overvalued under the auspices of exchange controls must be expected to adjust when exchange controls are removed; or repressed interest rates, sustained by exchange restrictions, must be allowed to rise to market equilibrating levels as exchange control liberalization proceeds (Collins, 1988).

Appreciation of the Real Exchange Rate

4.12 Authorities in many countries are also concerned that sizable capital inflows can lead to an appreciation of the real exchange rate, which could erode international competitiveness. This could be especially harmful to the export sector, but also to producers of import substitutes. Not confident in their ability in a liberalized environment to manage and maintain a stable, competitive real exchange rate, the authorities resist exchange control reform. One point to emphasise, however, is that exchange control liberalization is not likely to appreciably affect the exchange rate of a currency that is neither seriously overvalued nor undervalued compared to longer term fundamentals (Eichengreen et al, 1998).

4.13 Exchange control liberalization programmes cannot succeed without tackling the related issue of the mechanism for determining the exchange rate (Edwards, 1984). This can take various forms; but, it should aim at maintaining stable, competitive real exchange rates, with the ability to flexibly adjust to shocks as they arise. Some countries have found that exchange rate bands and/or crawling pegs-bands are effective exchange rate mechanisms for such policies (Edwards, 1989). Others have found that developing contingency plans to deal with shocks, while still aiming for stable, competitive real exchange rates and building up capacities to deal with shocks, can work (Bank of Botswana, 1996).

4.14 For example, Botswana, after it suffered a serious external shock in the second half of 1981, when the market for its major export, diamonds, collapsed and the country was unable to sell any diamonds for six months, adopted a contingency strategy to ensure it could cope with future shocks in a prudent and timely manner, without having to reverse its commitment to a policy framework of a liberal foreign exchange regime, open trade and market-oriented, investor-friendly private sector development. In addition to standing ready to implement fiscal adjustments of tax increases and expenditure cuts, interest rate increases and exchange rate devaluation, as it did early in 1982, Botswana decided, after a review of the likely shocks it could face, to adopt a target of having 9-11 months of foreign exchange reserves.

4.15 Achieving that target was built into its national development plans and annual budgets. If the actual level of international reserves fell below 11 months, the government would start formulating the detailed adjustment plan needed, and if the level fell below 9 months, the adjustment plan would be implemented. Subsequent to that early 1980s experience, despite successive balance of payments surpluses and the build up of international reserves above the 11 month upper target range, Botswana has pursued a deliberate policy of not allowing its real exchange rate to appreciate more than a couple of percent before initiating adjustment measures, such as curtailing wage increases (including government wage freezes) and periodic devaluations, to maintain a stable, competitive real exchange rate.

Loss of Independent Monetary Policy

4.16 Perhaps the major concern of monetary authorities is the loss of their ability to operate an independent monetary policy in a liberalized foreign exchange regime. In the absence of exchange controls, real interest rates would move in line with those in the major international markets, and the exchange rate could become more volatile, possibly deterring investment in a country like Ghana.

Loss of Tax Revenue

4.17 The possible loss of tax revenue is an obvious area of concern to the authorities that would need to be addressed in a programme of exchange control liberalization. In order to deal with the possible erosion of the tax base that could arise from exchange control liberalization, the tax system should be transformed to a world-wide source basis for taxation, which will make foreign earnings liable for tax (Phaleng, 1994). In addition, some recovery of lost revenue could be achieved through imposition of a small transactions tax on foreign exchange dealings (Jefferis, 1997). Moreover, there could be revenue gains to the government via some savings that the central bank might enjoy from needing to mop up less excess liquidity via open market operations. Also, the efficiency gains of capital market liberalization should be expected to lead to greater taxation from the returns to increased investment and higher levels of profit that growth of the economy will foster (Mabe, 1996).

Local Industries Protected by Exchange Controls

4.18 Exchange control regimes that have served to protect some local industries could be expected to give rise to opposition to reform from those who might be adversely affected (e.g., the insurance industry). The authorities would need to consider the winners and losers from exchange control liberalization, and transitional measures that might smoothen the path to a more efficient and equitable system. As regards the problem that protected industries might suffer as a result of exchange control liberalization, such industries could be, and should be, provided with direct, explicit assistance and/or subsidies, if such interventions are indeed justified (Bank of Botswana, 1996; Collins, 1988). Such an approach would often lead to better and more informed public policy decisions regarding subsidies, as many exchange control restrictions adopted to protect domestic industries are not likely to pass objective assessments for direct budgetary support (Jefferis and Harvey, 1995).

Conduit for Capital Flight and/or Illegal Money Laundering

4.19 Any programme for exchange control liberalization should also address concerns regarding whether liberalization might lead the country to become a conduit for capital flight from neighbouring less liberalized regimes, and/or a venue for illegal money laundering. But, money laundering should be combatted directly through the efforts and legal framework of the banking supervision and investigative authorities, not through exchange control (Montiel, 1998). While the same restrictions and reporting requirements might still used, and implemented through the same government agencies, e.g., customs officials checking on movement of currency across borders, they would not be exchange controls.

Shift of Foreign Exchange Reserves Private Sector

4.20 Many authorities are likely to be concerned that liberalization of the capital account will probably lead to a shift of the nation's foreign exchange reserves from government hands to private sector hands. But, if the nation's economic agents are allowed to hold asset portfolios in the form they desire, with the mixed of domestic and international assets they think best, governments do not then need to hold international reserves on their behalf. The authorities need only hold reserves to cover official requirements, including a provision for contingencies. Thus, the issue of privately held international reserves should not be a cause for concern, especially for those authorities committed to liberalized, market-oriented, private sector-led development strategies.

Concern about Statistics for Balance of Payments and National Accounts

4.21 With regard to the concern for statistics, that should not be a basis for retaining exchange controls. Many countries, often with advice and assistance form the IMF, have found alternative ways to improve reporting mechanisms, as well as introduce sample surveys and computerization, with the result of being able to provide more reliable and timely statistics for the balance of payments and the national accounts (Hanson, 1992; Montiel, 1998).

5 How Does Ghana Fare with Respect to the Various Concerns?

Destabilising Capital Outflows

5.1 Ghana has already sent strong signals that government is committed to creating and maintaining an investor friendly investment climate. While progress has been recorded in developing an effective regulatory authority to provide prudential oversight of the money and capital markets, unfortunately, government has had difficulties in establishing the prerequisite of a sound and sustainable macroeconomic policy framework to back such a commitment (World Bank, 1998). Because Ghana is suffering macroeconomic instability at present, capital account liberalization could indeed prove destabilising. The authorities need to put in place a credible macroeconomic policy framework that is perceived to be logically consistent and sustainable, and capable of responding to the various shocks, external or internal, to which the economy might be subjected.

Inability to React Quickly Enough

5.2 Ghana has not demonstrated the ability to make timely adjustments to shocks, such as the terms of trade shocks it experienced in 1999 with respect to the fall in cocoa and gold prices and the rise in oil prices. Whether that was due to over-optimism or inertia is not known. Once the significance of the terms of trade shock was manifest in early in 1999, the government was not ready to implement needed fiscal adjustments of tax increases and expenditure cuts, along with interest rate increases and exchange rate devaluation, to deal with the shock. Rather, the authorities, in addition to setting cocoa prices in Cedi terms at a level they could not sustain, sought to maintain an expenditure programme they could not finance with existing revenue sources. Instead, they began building up arrears and obligations to contractors and other institutions (e.g., SSNIT), and they attempted to maintain an unsustainable overvalued exchange rate through repression of the foreign exchange markets (CEPA, 2000).

5.3 In so doing, not only did the authorities lose credibility, the economy was burdened with the inefficiencies of queues for foreign exchange, greater uncertainty regarding actual exchange rates at which foreign exchange could be secured, a resurgence of the parallel market, higher interest rates, and a greater squeezing out of the private sector from access to credit for productive investments.

5.4 Thus, another key ingredient for successful exchange control liberalization, of being able to respond timeously with a credible and transparent macroeconomic policy framework that could limit contagion effects of external shocks that might arise, was not achieved.

Speculative Asset Price Bubbles

5.5 With respect to the policy tools needed to manage capital inflows in a liberalized environment, Ghana has the three main instruments of sterilisation, fiscal policy and exchange rate policy at its disposal. In addition, the Bank of Ghana has the powers to introduce special, short term measures to manage potentially volatile capital flows, e.g., marginal reserve requirements (Leith and Söderling, 1999). But, it would seem the monetary authorities' ability to manage capital flows with those instruments and initiate policy actions timeously would need to be strengthened.

Risks to Financial Sector Soundness

5.6 With respect to prudential regulation and diligent supervision of the financial sector, Ghana has moved slowly to resolve problems of weaker banks (World Bank, 1998). The sagas of the Cooperative Bank and the Bank for Housing and Construction, as well as the 23 distressed rural banks, indicates the authorities allowed those institutions to operate and jeopardise the financial system for far too long. As at the end of 1999, over 50 percent of the remaining rural banks were rated "mediocre" with respect to satisfying prudential requirements (Bank of Ghana, 2000). Nevertheless, it is notable that the Bank of Ghana closed the operations of the two insolvent banks and 23 distressed rural banks, showing it does have the ability to enforce prudential regulation of the banking system. Thus, it would seem that major problems in Ghana's financial system can be adequately addressed before removing most restrictions on capital account transactions.

5.7 However, with respect to the markets for domestic equities and debt instruments, which are well-supervised, and their supporting infrastructure, these are not well-developed (World Bank, 1998). The market is relatively inactive and illiquid, with only small numbers and volumes of securities being traded. But, this could be, in part, a chicken and egg argument in that exchange controls may deter market participation, which then leads to illiquidity and the lack of resources to modernise the Ghana Stock Exchange and improve the efficiency of its trading, clearing, settlement and depository systems.

Appreciation of the Real Exchange Rate

5.8 With respect to the prerequisite of an appropriate and sustainable exchange rate policy, the record of the past three years demonstrates that Ghana has been less than successful. This was in part due to the failure of government to develop adequate contingency plans to deal with shocks to which the economy is subject. Government's target level of international reserves has proved inadequate to deal with the terms of trade shock from lower cocoa and gold prices and higher oil prices which Ghana suffered in 1999 (CEPA, 2000).

5.9 Existing exchange control restrictions on the capital account appear to be providing some support for a significant domestic macroeconomic disequilibrium, especially the fiscal imbalance; and it will be difficult to remedy that disequilibrium and the resulting macroeconomic instability the country suffers without resolving that imbalance (CEPA, 2000).

Loss of Independent Monetary Policy

5.10 With a flexible exchange rate, in the absence of exchange controls, Ghana would have some ability to exercise an independent monetary policy, especially if capital flows proved to be a bit sticky. But, the thrust towards regional economic integration and a second monetary zone, suggests that this issue will recede in importance anyway.

Loss of Tax Revenue

5.11 It might be difficult in the short term, given tax administration capacities, for Ghana to adopt a world-wide source basis for taxation, that would make foreign earnings liable for tax (Leith and Söderling, 1999). However, it would seem there is room for some recovery of lost tax revenue through imposition of a small transactions tax on foreign exchange dealings, which would also serve to slow down the pace of "hot money" capital account transactions. It also appears that exchange control liberalization could reduce the central bank's need to engage in open market operations to mop up excess liquidity, and thus there could be revenue gains to the government from Bank of Ghana's operations. More importantly, to the extent that exchange control liberalization leads to increased investment and higher levels of profit in a rapidly expanding economy, government could be expected to reap greater tax revenues.

Local Industries Protected by Exchange Controls

5.12 Because many people believed, and continue to believe, that exchange controls are needed to keep out foreign goods that can be produced domestically, irrespective of cost, price and quality differentials to consumers, Ghana has quite a few protected industries that might suffer, or just claim to suffer, as a result of exchange control liberalization. In large part, such protection is difficult to justify on social or economic grounds. However, political economy considerations might necessitate some concessions to ease the transition. To the extent such industries should be provided with help to adjust to a more liberalized environment, it should be in the form of direct, explicit assistance and/or subsidies (Bank of Botswana, 1996; Montiel, 1998).

Conduit for Capital Flight and/or Illegal Money Laundering

5.13 Ghana does not have clear laws and enforcement mechanisms to combat money laundering (World Bank, 1998). But, these would not be difficult to develop along the lines recommended by the Financial Action Task Force on Money Laundering (FATF), which relate primarily to customer identification and record-keeping, increased diligence by financial institutions in detecting and reporting suspicious transactions and measures to deal with countries with an inadequate framework for dealing with money laundering.

Shift of Foreign Exchange Reserves Private Sector

5.14 Judging by the comments of senior officials and the media in the context of the current currency crisis, with strong expressions to force remittances to Ghana and restrict payments to non-residents through regulatory means, rather than market mechanisms, the authorities and many members of the public need to be better educated regarding exchange control liberalization issues. Such a public education programme should be built into any strategies for exchange control liberalization.

Concern about Statistics for Balance of Payments and National Accounts

5.15 As regard to the concern for statistics, Ghana should be able to introduce improved reporting mechanisms and sample surveys to generate more reliable and timely statistics needed for the balance of payments and the national accounts without having to resort to cumbersome exchange control restrictions and reporting requirements.

6 Strategies for Exchange Control Liberalization

6.1 In order to implement a successful programme of exchange control liberalization, recognition must be given to needed pre-conditions and the appropriate sequencing of liberalization measures. First and foremost as a precondition is the need to achieve and maintain a stable macroeconomy prior to and after liberalization of the exchange control regime. The essential ingredient in that regard is to reduce fiscal deficits to sustainable, non-inflationary levels, or better still, to achieve budgetary surpluses (Bank of Botswana, 1998).

6.2 Also key to success in exchange control liberalization is the need to build up public confidence in the appropriateness of macroeconomic policy framework that is being pursued, and the authorities' ability to deal with shocks that might arise. Success here will depend critically upon the credibility and consistency of the entire set of macroeconomic policies being pursued, especially anti-inflation policy (Jefferis, 1997).

6.3 While it is nice to have abundant foreign exchange reserves (e.g., Botswana) when embarking upon an exchange control liberalization programme, that is not essential, if an appropriate macroeconomic policy framework is in place. A sound and sustainable macroeconomy would result in achieving and maintaining stable, low rates of inflation. Such macroeconomic stability would be fostered by market systems of flexible wages, prices and interest rates, in conjunction with a sound fiscal policy framework.

6.4 Also important as a precondition for exchange control liberalization is having a liberalised financial system, which manifests and encourages competition, but which additionally is subject to strong prudential supervision. The regulatory and supervisory authorities need to ensure that adequate risk management systems are in place in the banking and financial sectors. Furthermore, the monetary authorities should reduce differences between domestic and foreign real rates of interest prior to capital account liberalization. A further key requirement for successful exchange control liberalization is being able to manage capital inflows so as to avoid real exchange rate appreciation (Mohohlo, 1999).

6.5 With respect to the sequencing of capital account liberalization, a general prescription is that restraints on trade-related capital flows should be relaxed first. This should then be followed by removal of restrictions on foreign direct investment. The next step would be relaxation of exchange controls on foreign portfolio investment, after which constraints on other short term financial flows should be removed (Williamson, 1991).

6.6 Underlying the strategies for exchange control liberalization is the recognition that countries with prudent, consistent and non-inflationary macroeconomic, financial and fiscal policies stand to benefit most from capital account liberalization in terms of efficiency gains and risk diversification benefits. But, it is also crucial that steps are taken to strengthen the safety and soundness of the financial system in the process of liberalizing the capital account (Montiel, 1998).

6.7 To design a strategy for exchange control liberalization and build the consensus needed for its effective implementation, the Government should establish a task force. The terms of reference of the task force will include addressing in detail in respect of Ghanaian conditions all the concerns listed above, along with other concerns that may arise from consultations with various stakeholders. The task force would review the existing exchange control regime, identify and prioritise actions needed in a strategic plan for exchange control liberalization, which could then be vetted at public fora before final submission to Government and subsequent consideration by Parliament (Jefferis and Harvey, 1995).

7 Recommendations

7.1 Ghana needs to foster, as rapidly as possible, economic diversification and accelerated growth if it is to achieve its Vision 2020 objectives. The existing exchange control regime is a major impediment to increased productive investment in Ghana, by both Ghanaian and foreign investors. Exchange controls act as major constraints on service-related investment and effectively preclude Ghana from developing into a regional centre for private sector administrative, technical and financial activities. Exchange control liberalization is needed to boost Ghana's prospects for attracting and developing new engines of growth, promoting job creation and increasing standards of living. Failure to push forward with exchange control reforms will leave Ghana further behind the other liberalizing economies and the more advanced industrial nations.

7.2 Exchange Controls should be removed as soon as possible, in a deliberate and progressive liberalization approach. This should be viewed as part of the process of economic development and the opening up of the economy so that it can benefit from greater integration with the international economy. From the point of view of enhancing policy credibility, exchange control liberalization reforms should be irreversible.

7.3 Prior to embarking on any strategy of exchange control liberalization, Ghana must first establish a stable macroeconomy. Subsequent to that, measures to satisfy certain preconditions to avoid disruption and destabilisation of the macroeconomy during the processes of reform and liberalization can be pursued. The steps of exchange control liberalization should be prudently compressed, taking into account the need to have the requisite preconditions and safeguards in place. The monetary authorities especially need to develop a willingness and ability to respond quickly to international market changes and large capital flows.

7.4 There should be consistency in the economic policy framework to foster credibility amongst both domestic and international economic agents. Fiscal, monetary, financial sector, exchange rate, trade and labour market policies should be coordinated so that they complement each other in achieving and maintaining macroeconomic stability, and in creating an economic environment that facilitates private sector growth.

7.5 A phased, progressive liberalization of the exchange control regime can enable and help build policy credibility. Such a strategy can allow time to develop the financial system's ability and sophistication to handle increased capital flows with wider range of financial assets and instruments. It can also allow time to improve the monetary authority's ability to sterilise large capital flows by introducing new and improved mechanisms for monetary management, which can additionally improve the authorities' effective control over domestically generated inflation.

7.6 The steps for exchange control liberalization should include:

(i) public commitment by the authorities to the process of progressive exchange control liberalization, with an indicative time limit to complete the process;

(ii) progressive liberalization of restrictions on foreign currency holdings and transactions by residents;

(iii) permitting residents to purchase property and other assets abroad up to a higher annual limit, which is progressively relaxed;

(iv) relaxing restrictions on purchases of shares and other financial assets by non-residents;

(v) reforming tax regulations, and developing alternative tax regimes to make up for lost revenues;

(vi) transferring protection of special industries to other authorities and legal provisions, if such special assistance and preferential treatment is still considered desirable;

(vii) making non-resident earnings from Ghanaian-based financial assets non-taxable in order to develop Ghana's potential as an international financial services centre;

(viii) strengthening banking guidelines to combat money laundering and fraudulent activities; and

(ix) strengthening statistical collection capabilities, and developing alternative sources of data for the balance of payments and national accounts.

7.7 There are concerns that need to be addressed carefully by the authorities and other stakeholders in designing the strategies they wish to pursue in liberalizing the remaining exchange control regulations. Key to successful exchange control liberalization is the need to establish and maintain a sound, credible macroeconomic policy framework, one which will inspire investor confidence over their investment horizons. Such a framework will depend foremost upon government having a sound and sustainable fiscal policy, with expenditure programmes that can be financed without excessive burdens on the private sector, either in the form of high taxes and/or inflation. The fiscal policy framework must be complemented by a monetary policy framework that is directed at achieving and maintaining monetary stability, as reflected in low and stable rates of inflation and rates of growth of money and credit in line with growth in the economy's productive capacity. These policy frameworks should be highly visible, and the subject and result of broad participatory policy consultations.

7.8 If Government wishes to adopt a strategy for exchange control liberalization, and is willing to commit itself to achieving the prerequisite of a stable macroeconomy, it should commission a task force to address in detail all the concerns various stakeholders may have regarding exchange control liberalization, as well as review the existing exchange control regime, and identify and prioritise actions needed in a strategic plan for exchange control liberalization.

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Appendix 1 The Extent of Capital Account Exchange Controls

1.1 While Ghana has liberalized exchange controls substantially since commencement of the Economic Recovery Programme and acceded to the obligations of Article VIII Status under the IMF Articles of Agreement, there are still extensive and onerous exchange control restrictions in place, especially on the capital account (IMF, 1998).

1.2 Exchange controls are still applied to trade in gold, and the export and import of banknotes. Under the exchange control regulations, domestic currency accounts are convertible into foreign currency, but only for approved purposes. Foreign currency accounts may be debited for inward payments, for transfers to other foreign currency accounts and for purchases of foreign currencies, upon approval by the BoG.

1.3 Exporters are required to repatriate the full proceeds of their sales within 60 days of shipment; however, proceeds from non-traditional exports may be sold to foreign exchange bureaux upon receipt. There are surrender requirements for foreign exchange earnings: exporters are generally allowed to retain 35% of proceeds in foreign currency accounts. But there are special foreign exchange retention provisions for selected groups; e.g., 60% for Ashanti Goldfields Company, 20% for log exporters, 2% for Cocobod, and there are no restrictions on retention of foreign currency by non-traditional exporters (i.e., they can retain 100% of their earnings of foreign currency from non-traditional exports).

1.4 Exchange control regulations require that freight charges must be paid to local agents, with proper documentation. Other exchange control restrictions provide that commissions are subject to quantitative limits, and amortization of loans requires prior approval from the BoG. The exchange control regulations further require that all proceeds from invisible transactions and current transfers must be sold to authorised dealers. There are quantitative exchange control limits on payments for travel and amounts of local and foreign currency that can be carried abroad.[1]

1.5 Exchange controls on capital account and money market instruments are still quite restrictive. For example, non-residents are limited individually and collectively to no more than 10% and 74%, respectively, of securities listed on the GSE. For unlisted companies, there are minimum required equity injections by non-residents seeking to acquire shares, depending upon ownership composition of the company.

1.6 The sale or issue locally of securities by non-residents requires prior approval of the BoG. While there are no restrictions on purchases of shares abroad by residents, the purchase of foreign exchange for such purposes requires prior approval of the BoG. Analogously, the sale or issue of securities abroad by residents requires prior approval of the BoG, as does the sale or issue locally of bonds or other debt securities by non-residents or the sale or issue of bonds or other debt securities abroad by residents.

1.7 The purchase of money market instruments by non-residents bringing in foreign exchange is not allowed under current regulations. However, non-residents holding local currency can invest in money market instruments. Also, the sale or issue locally of money market instruments by non-residents is not allowed. While there are no restrictions on purchases of money market instruments abroad by residents, the purchase of foreign exchange for such purposes requires prior approval of the BoG. The sale or issue of money market instruments abroad by residents is not allowed.

1.8 The purchase of collective investment securities by non-residents locally requires prior

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[1] Many countries impose limits on carrying currency across borders without declaration as an measure to combat crime and money laundering. But, that should be consider distinct from exchange controls to protect the balance of payments and regulate legitimate international transactions.

approval of the BoG, while the sale or issue locally of collective investment securities, as well as the transfer abroad of sales proceeds, by non-residents requires prior approval of the BoG. There are no restrictions on purchases of collective investment securities abroad by residents; but the purchase of foreign exchange for such purposes requires prior approval of the BoG. The sale or issue abroad of collective investment securities by residents requires prior approval of the MoF, while the purchase of foreign exchange for transactions in derivatives requires prior BoG approval.

1.9 Prior approval from the BoG is required for commercial credits to residents from non-residents; and these credits must be channelled through the banking system. Similarly, prior approval from the BoG is required for financial credits to residents from non-residents. All applications for outward direct investment (capital outflows), adequately supported by documentary evidence, must be approved by BoG.

1.10 Certain areas of economic activity are not open to foreigners. Foreign investments in Ghana require prior approval of GIPC, if they are to benefit from facilities under the Investment Code, including investment guarantees, rights of transfer of profit and capital proceeds, tax holidays and capital allowances, and dispute settlement. There are controls on the purchase of real estate abroad by residents and the sale locally by non-residents. There are controls on personal capital movements, including restrictions on loans by residents to non-residents, to residents from non-residents, the settlement of debts abroad by immigrants, and the transfer abroad of assets by emigrants.

1.11 Commercial banks are required to notify the BoG of their borrowing abroad, as well as their maintaining accounts abroad. There are restrictions on commercial bank lending to non-residents, lending locally in foreign exchange, purchasing locally issued securities denominated in foreign exchange and open foreign exchange positions.

1.12 There thus remain considerable restrictions on foreign exchange transactions, which impact not only on capital account transactions, but also on current account activities. Some of these latter restrictions (e.g., freight charges) serve as impediments to trade and investment, in some cases seriously undermining the competitiveness of non-traditional exporters.

Appendix 2 Reasons and Rationale for Adopting Exchange Controls

2.1 There have been numerous reasons espoused over the years for adopting exchange controls over current account and capital account transactions, especially by developing countries, which after independence sought to have their own currency and an independent monetary policy. The transition to a new currency and potentially different monetary policy framework, along with a new financial sector regulatory dispensation, typically gave rise to a good deal of uncertainty regarding the public's confidence in the new local currency and the economy. Exchange controls were viewed as a means to deal with the fear many authorities had that foreign exchange held by foreigners and foreign-owned companies would quickly flow out of the country (Mabe, 1996).

2.2 In other cases, exchange controls were instituted to give the authorities control over local borrowing by foreign-owned companies, ensuring that the foreigners brought in some capital with their involvement in the local economy. Related to that, and perhaps more important from the perspective of the widely held views at the time, was the desire by many newly independent countries to gain control over the "commanding heights" of their economies; exchange controls were seen as a means to control the activities of foreign companies, whose interests might not coincide with those of the host country (Collins, 1988).

2.3 Another major reason for adopting exchange controls by many developing countries, which, as primary commodity producers and exporters, were vulnerable to external shocks, was to be able to regulate the outflow of foreign exchange in the event of an adverse shock. But, more often than not, exchange controls became a rationing mechanism for overvalued exchange rates for many countries that were unable or unwilling to adopt sound macroeconomic policies that could ensure a sustainable balance of payments. Exchange controls were, thus, a means to restore external balance in situations where the authorities were not willing to allow the exchange rate to be determined by market forces, while they pursued inconsistent macroeconomic policies (Leith, 1996).

2.4 In some cases, countries implemented exchange controls as a means of promoting import substitution; restricting the availability of foreign exchange for purchases of goods that the authorities desired to be produced domestically. In other instances, the authorities justified exchange controls as a means to optimise the utilisation of available limited resources, either to prevent the importation of non-essential or socially undesirable goods, or to foster the development of strategic industries, deemed especially valuable to the nation (Mabe, 1996). Thus, at least from the perspective of the authorities, exchange controls were touted as a mechanism for picking "winners" and/or redistributing limited national resources from the rich to the poor.

2.5 Other countries adopted exchange control out of concern over the potential loss of the tax base for government revenue. Exchange controls served to enable the authorities to enforce tax compliance, or more efficiently administer customs and excise taxes. In addition, many countries used the exchange control regulations as a criminal investigation tool, allowing the authorities to trace money flows and detect possible illegal behaviour (Bank of Botswana, 1996).

2.6 Less often mentioned as a major justification for exchange controls is the desire by people in authority to be able to garner other people's money, giving those people less than the full value for the foreign exchange they earned or by imposing special taxes on the foreign exchange or by resorting to an inflation tax for people who cannot convert their local currency holdings to more inflation-proof assets abroad.

2.7 Finally, some countries justified exchange controls, or the retention of them even after they had accepted the logic and case for exchange control liberalization, on the grounds of needing statistics for the balance of payments and the national accounts (Mabe, 1996).

Appendix 3 Record of Exchange Control Implementation

3.1 While there were ample, and often well-intentioned, justifications for exchange controls, the record, more often than not, left a lot to be desired. Invariably, over time, more and more people found ways to evade the exchange controls, while the systems themselves proved to be costly and counter-productive (Jefferis, 1997).

3.2 Generally, capital account controls proved very leaky, as exporters found ways to under-invoice their exports and importers found ways to over-invoice their imports, in both cases having much of the difference deposited in undisclosed accounts and/or invested in other foreign assets. Other people found ways to evade exchange controls through hidden transactions; e.g., providing services to or paying the local costs of non-residents or visitors to Ghana in exchange for undisclosed foreign assets (Williamson and Lessard, 1987).

3.3 Exchange controls often proved to be a very regressive system, with the larger and more well-to-do economic agents better able find ways around controls. This was often because the exchange control system became very corrupt, with rent-seekers, who know the channels to secure special dispensations from the exchange control authorities, bribing officials who have an undervalued asset to dispense. Invariably, exchange control regimes led to illegal (parallel) foreign exchange markets, the smuggling of currency in and out of the country, underpricing of exports and overpricing of imports, and illegal capital flight (Leith, 1996).

3.4 Exchange control systems also tended to take on a life of their own, as the exchange control bureaucracy attempted to maximise its own power and wealth, and resorted to ever more restrictiveness, secretiveness and delaying tactics as the exchange control regime became less and less effective (Leith and Lofchie, 1993). Dealing with such bureaucracies and their ad hoc arbitrary procedures not only was extremely frustrating and time consuming, it also involved a great deal of uncertainty, which further served as an impediment to productive economic activities (Montiel).

3.5 Of course, as a general rule, given the objectives that exchange controls sought to achieve, they distorted the relative prices between tradeable goods and non-tradeable goods, they added to banking system costs and distorted other business costs, thus reducing profitability and the competitiveness of exporters especially, but tradeable goods producers more commonly. Also as a general rule, the authorities' reliance on exchange controls was typically biased towards goods that government desired for socio-political reasons, not necessarily for truly productive investments, and thus the exchange controls served to retard economic growth (Collins, 1988).

3.6 In many cases where exchange controls were used to protect an overvalued exchange rate, while that exchange rate enabled the restricted imports to be obtained at a lower cost in domestic currency terms, it was usually associated with higher inflation as the authorities, shielded by exchange controls, pursued excessively expansionary fiscal policies financed through money creation (Leith, 1996).

3.7 Over time, many countries (and their authorities) came to realise that there were additional costs associated with exchange control regimes that made their continuation less justifiable. Exchange controls deny residents opportunities to benefit from technological progress and financial innovations that are available in more developed countries. In addition, exchange controls not only reduce the opportunities of businesses to manage the risk inherent to international trade, they also raise the transaction costs of doing business or investing internationally (Jefferis and Harvey). As such, exchange controls frustrate efforts to promote and achieve regional economic integration. Furthermore, exchange controls limit the duration and types of contracts that residents may enter into through domestic financial institutions, thus hindering residents' opportunities to optimally protect against financial risks in managing their investment portfolios (Mathieson et al, 1993).

3.8 The history of exchange controls remains a blotch on the records of many well-intentioned governments, in some cases over-shadowed by their other strategies and policies that left a legacy of economic mismanagement (Leith, 1996). The use of exchange controls, whatever their initial justifications and objectives, has largely been inefficient and counter-productive, giving rise to perverse behaviours, malpractices and corruption.

Appendix 4 Costs and Benefits of Exchange Control Regimes and Exchange Control Liberalization

4.1 Exchange controls, whatever their intended benefits, have entailed a variety of direct and indirect costs on businesses, workers, households, government and the national economy. Such costs need to be weighed carefully against the benefits such controls are intended to generate, just as the costs and benefits that would accompany exchange control liberalization need to be weighed.

4.2 Exchange control systems involve the direct administrative costs of the exchange control regulator (the Bank of Ghana), as well as the accompanying administrative costs of commercial banks and foreign exchange bureaux in complying with the exchange control regulations (Bank of Botswana, 1998). In the case of the direct costs incurred by the Bank of Ghana in administering exchange controls, these need to be funded through the central bank's budget, which, at the end of the day, comes out of the government's treasury. In the case of the costs of the authorised dealers, the costs of administering exchange control are included in the commissions and/or margins, which is borne by the persons buying or selling foreign exchange.

4.3 The exchange controls that require remittance of foreign exchange earnings entail additional foreign exchange transaction costs for businesses that export and also purchase needed imports for their operations: there are charges and commissions when the export receipts are converted into local currency and then there are further charges when the local currency is converted back to foreign exchange to pay for imports. Such exchange control costs are an unnecessary deadweight loss to the economy, which serve as an impediment to investment in productive businesses (Jefferis, 1997).

4.4 There are also direct costs involved in the delays businesses and economic agents faced waiting for exchange control approvals. Funds are tied up during that period, generating lower returns and/or benefits than they might in the absence of exchange controls (Jefferis and Harvey, 1995).

4.5 While difficult to quantify, exchange controls act as a constraint on inward investment, reducing the rate of return and thus the level of investment in Ghana. In a related manner, exchange controls retard Ghana's prospects of developing into an international financial services centre and/or regional administrative centre for many multi-national companies (Leith and Söderling, 1999).

4.6 By restricting certain kinds of contracts and restricting borrowing, exchange controls reduce resident firms' access to the best, most suitable funding for their activities. Exchange controls also serve to discourage foreign firms from bringing in capital in the form of shareholders' loans (Mohohlo, 1996).

4.7 Exchange controls, by restricting wealth protection, portfolio diversification and risk management activities, reduce Ghanaians' overall well-being in terms of achieving the highest returns possible within preferred acceptable levels of risk. To the extent exchange controls are effective, Ghanaians end up with lower levels of income from their assets, while being made more vulnerable to risks and uncertainties. Exchange controls also discourage domestic savings, especially in financially repressed markets, when real rates of interest are negative. Exchange controls result in the mispricing of domestic assets, especially property, which serves to further retard investment in productive tradeable goods activities (Mathieson et al, 1993).

4.8 As noted above, exchange controls almost invariably lead to rent-seeking behaviour and corruption; the resources expended in rent-seeking are not productively employed from a national perspective. Exchange controls generally create a bad impression, a poor image internationally, about the country that resorts to them: exchange controls are typically associated with a poorly-managed economy, often with an over-valued exchange rate (which makes local businesses uncompetitive internationally), with fiscal imbalances and a very risky business environment (Bank of Botswana, 1996).

4.9 The benefits of exchange controls were covered generally in the reasons and rationale for many countries adopting such regimes. With exchange controls in place, government believed it would be able to increase its tax revenues, e.g., through taxation of interest on local financial assets. Government and the central bank believed they would be able to have higher levels of foreign exchange reserves, although the record at best suggests this is only a short run phenomena, if leakage is difficult and other responses are not perverse (Mabe, 1996).

4.10 Exchange controls do allow a more independent monetary policy, giving the authorities greater control over domestic interest rates and exchange rates. But, even that has tended to prove ephemeral when the authorities did not pursue sound, complementary macroeconomic and monetary policies (Jefferis and Harvey, 1995). Without exchange controls, the market would force a greater discipline on the authorities to pursue sound economic policies, since people would have greater ability to adjust their behaviour and portfolios to avoid the adverse effects of inappropriate policy frameworks.

4.11 Exchange controls can provide a mechanism to correct for inefficiencies that can arise in capital markets when there is asymmetric information in the financial system (Montiel, 1998). These inefficiencies can result in adverse selection, moral hazard and herding, and domestic distortions, which warrant second-best solutions. For example, when inadequate information on credit-worthiness is pervasive, lenders will tend to lend at interest rates that reflect the average quality of borrowers, thus disadvantaging high quality borrowers with good projects while allocating loanable funds to lower quality borrowers with relatively poor and/or high risk projects. As a result of the information asymmetry, there is a sub-optimal level of financial intermediation and productive investment.

4.12 But, problems of asymmetric information can often be better addressed through policies that lead to adherence to best international practice for accounting, auditing and information disclosure (e.g., strict banking and capital market supervision), that enforce sound corporate governance and that protect investors and lenders from fraud and unfair practices (e.g., a credible judicial system and efficient bankruptcy procedures). Similarly, second best solutions for domestic distortions, many of which are the result of public policy and the institutional framework, can be best remedied by correcting government policies, not by retaining a burdensome layer of regulation (Bank of Botswana, 1998).

4.13 As would be expected, many of the benefits of exchange control liberalization derive from the direct and indirect costs of exchange control systems. A strategy of exchange control liberalization will signal that the authorities will ensure the necessary prerequisites of credible and consistent policies are in place so that liberalization will be sustained.

4.14 One of the primary benefits of liberalization of the capital account is that capital mobility creates opportunities for portfolio diversification, mutually beneficial risk sharing and intertemporal trade, thus smoothing intertemporal consumption patterns and easing adjustments to exogenous price and income shocks (Edwards, 1984).

4.15 There would be the saving of direct financial costs and time in an economy free of exchange restrictions. Scarce central bank and financial sector manpower would not need to be tied up administering exchange controls and trying to enforce them (Jefferis, 1997).

4.16 Exchange control liberalization also typically results in an expansion of gross capital flows as economic agents, both resident and non-resident, take advantage of opportunities to diversify portfolios in search of highest returns. Exchange control liberalization results in an improved global allocation of resources; it provides greater business freedom to identify and pursue the most productive investments and activities (Mohohlo, 1999).

4.17 Liberalising exchange controls would create an improved business environment, foster regional integration and promote Ghana's prospects to be a regional hub for business activities. Such an environment would encourage financial innovations and competition, allow Ghana to be an international financial services centre, providing opportunities for off-shore banking, international finance-related services (leasing, insurance and reinsurance, pension and mutual fund management, and consultancy), and representative offices of international banks and firms to be more easily established and operational in Ghana (Phaleng, 1994).

4.18 Exchange control liberalization, in an environment of macroeconomic stability supported by sound macro policies, would foster job creation due to increased investment, but there would be job savings for the unproductive exchange control regulation jobs made redundant. In the aggregate, there would be increased economic growth due to efficiency gains and cost savings.

4.19 Exchange control liberalization would serve to attract foreign direct investment, especially for export-led growth, but it would also have salutary effects on financial resources available for domestic investment, for acquiring improved managerial and technical skills, for developing marketing skills and access to markets, for increasing competition and innovation (Bank of Botswana, 1996). Exchange control liberalization, thus, would foster sustainable economic diversification into existing and new areas of agriculture, manufacturing, mining, tourism, transport and communications and a variety of financial services.

4.20 Exchange control liberalization would add to the distinction of Ghana in eyes of both foreign and local investors. It would signal Ghana's commitment to open markets and the discipline of the global economy.

4.21 Exchange control liberalization would lead to improved financial system performance, improved asset pricing, increased real rates of return on investment, efficiency gains, productivity improvements and greater financial innovations. The improved environment would lead to an expansion of the money and capital markets. There would be an improved access to international financial markets, thus reducing the cost of capital to Ghanaian enterprises (Montiel, 1998). The liberalised environment would allow for currency hedging opportunities, as well as increased opportunities for outward investment by residents, leading to higher real national income, and better risk management (Mohohlo, 1996).