Ghana Strategy Support Program-IFPRI
Discussion Brief 1

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Aiming for Middle-Income Country Status: What Are the Growth Options?

It is almost certain that Ghana will become one of the few African countries to achieve the first Millennium Development Goal (MDG1) earlier than the target year of 2015. The country is also in a good position to sustain the 6 percent agricultural growth rate targeted by the Comprehensive Africa Agriculture Development Programme (CAADP). The Government of Ghana has also declared a more ambitious development goal of reaching middle-income (MIC) status by 2015. This brief summarizes the lessons learned from other countries and analyzes the growth and investment options needed in order for Ghana to reach its MIC goal.

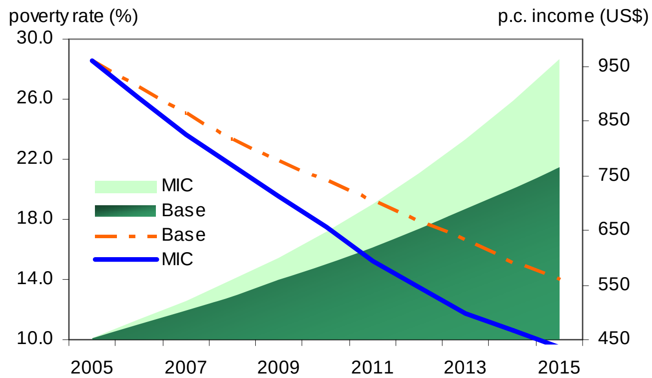
Accelerated Growth is Needed to Achieve MIC Status

Ghana's per capita income (or GDP) is currently US$450, while the income level of a MIC typically begins around US$1,000. Ghana will therefore have to more than double per capita incomes during the next 10 years if it hopes to achieve MIC status. Evidence from successful countries shows that the GDP growth rate required to achieve MIC status has varied from 6 percent in Malaysia and Thailand to around 10 percent in China and Brazil. Although commendable, Ghana's GDP growth rate has only averaged 5.5 percent in the past five years (or 2.3 percent in per capita terms), which is significantly lower than in most successful countries. However, a country's per capita income, measured in current U.S. dollars, is also influenced by non-growth factors such as changes in real exchange rates or population growth rates. Taking these factors into account, a recent study by the International Food Policy Research Institute (Breisinger et al. 2007) estimates that Ghana would need around an 8 percent annual growth rate during the next 10 years to reach MIC status—a rate much higher than the country's current growth trends (see Figure 1).

Structural Change Remains a Challenge for Ghana

Countries that have reached MIC status have typically undergone a process of 'structural transformation,' during which rapid growth often redefined the role of different sectors in their economies. Manufacturing usually drives structural change, but export-oriented services can also play a leading role (such as has occurred in India). While the contribution of agriculture to overall growth has typically declined, the sector has usually continued to grow. For example, Malaysia maintained a high agricultural growth rate of 5.9 percent, while its manufacturing sector grew at a rate of 10 percent during the same period.

Figure 1—Projected growth and poverty reduction



Source: Authors' calculations based on Breisinger et al. 2007

Compared with other successful countries, agriculture in Ghana today is far more important and the manufacturing sector is much smaller than was the case for other successful countries when they were at similar income levels. While these substantial differences in the countries' initial conditions may indicate that a different growth path is required for Ghana to reach MIC status, the small size of the country's manufacturing sector and the lack of competitive export services are likely to pose a huge development challenge.

Rapid and Diversified Export Growth is Required

Exports in other successful countries grew more rapidly than did the overall economy, and export structures diversified both across sectors and within agriculture during the periods of structural transformation. While Ghana's exports did grow faster than GDP between 2000 and 2006 (at a rate of 9 percent), such growth is still far below that of the successful countries. With the exception of Malaysia, the dominant role of traditional agricultural exports significantly declined during structural transformation. By contrast, Ghana's exports are still dominated by cocoa, gold, and forestry, which together make up two-thirds of total exports. This export structure is likely to constrain the role of external markets in accelerating growth in Ghana.

What Are Ghana's Growth Options for Becoming a MIC?

Accelerated growth, structural transformation, and export diversification were commonly observed in successful countries. However, the development paths needed to reach MIC status varied from country to country. The following sections summarize the main findings of an IFPRI study (Breisinger et al., 2007) that used a dynamic economy-wide model to examine the different options and challenges for raising growth in Ghana during the next 10 years.

Agriculture will remain the main driver of growth

Agriculture is the backbone of Ghana's economy, accounting for 40 percent of GDP and employing 55 percent of the labor force. Given these unique initial conditions, the agricultural sector will have to play an important role in achieving MIC status. If agriculture can maintain its current momentum of 5.7 percent annual average growth during the next 10 years, then the sector will remain the most important contributor to reaching MIC status. Substantial gaps between actual and potential yields for most crops indicate that higher agricultural growth is possible. With increased public and private investments in agriculture and the rural sector, Ghana could reach beyond the CAADP target of 6 percent annual growth.

Both exportable and staple commodities will be important to support rapid agricultural growth. Staple commodities, which account for more than 50 percent of agricultural GDP, constitute a reliable source of growth, driven by an expanding population, income growth, and urbanization. Rice and poultry, for example, have high income elasticities and the potential for import substitution. But Ghana will face increasing competition from imported foods, and for traditional and nontraditional exports in foreign markets. To meet these challenges, it is essential that accelerated growth in agriculture be driven by enhanced productivity and increased competitiveness, rather than by the land expansion of the past.

Manufacturing growth may play a limited role

Ghana's manufacturing sector is not only small (less than 10 percent of GDP), but is also dominated by food and agricultural processing. The small initial size indicates that even very high growth in the sector may be insufficient to significantly influence economywide growth. In addition, the sector's high dependency on agricultural inputs implies that manufacturing growth may be constrained by agricultural growth. The model simulations show that the contribution of Ghana's manufacturing sector to overall growth will increase only marginally—even if the sector grows at more than 10 percent per year during the next 10 years.

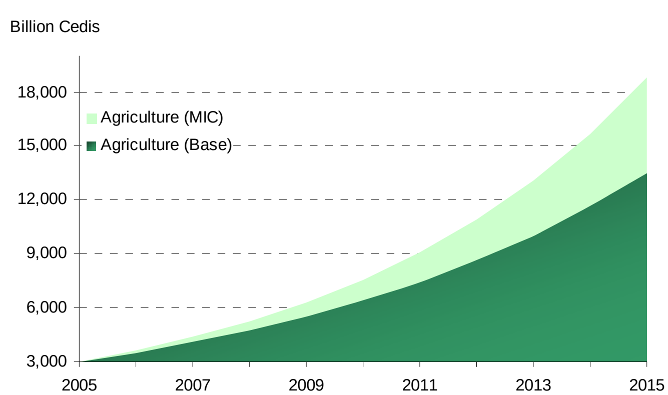
Services have strong growth linkages

Domestic-market-oriented services—such as wholesale and retail trade, transport and communications, and business services—constitute more than half of Ghana's private service sector and are 50 percent larger than the whole of manufacturing. While the service sector may not be the prime mover of growth, improvements in its productivity or efficiency will benefit all other sectors and generate additional economywide growth. For example, according to the National Resources Institute (2006), trade and transport costs account for 45 percent of the maize price paid by consumers in Accra markets. Improvements in service-sector productivity will lower transaction costs and increase the competitiveness of domestic agricultural goods vis-à-vis imports, thereby providing additional income opportunities for Ghanaian farmers. A further example is the banking sector, where improved banking efficiency would lower risk in the sector, which in turn would reduce interest rates, benefiting growth in other sectors through lower production and investment costs.

Public agricultural expenditure has to increase

To reach MIC status, more public investment will be necessary for improving public services and attracting private investment. Increasing public agricultural expenditure (PAE) is especially important, as was emphasized in a recent IFPRI study that showed that a 1-percent increase in Ghana's public agricultural expenditure (PAE) is associated with a 0.17-percent increase in total agricultural production (Benin, 2007). The study also showed that in order to support the accelerated growth needed to reach MIC status, PAE has to increase from the current 8.5 percent of total government spending to 11 percent by 2015. This translates into an additional 4 percent of real annual growth in PAE, which will also allow Ghana to meet the CAADP target (see Figure 2).

Figure 2—Estimated public agricultural expenditure needed to reach MIC 2005-2015



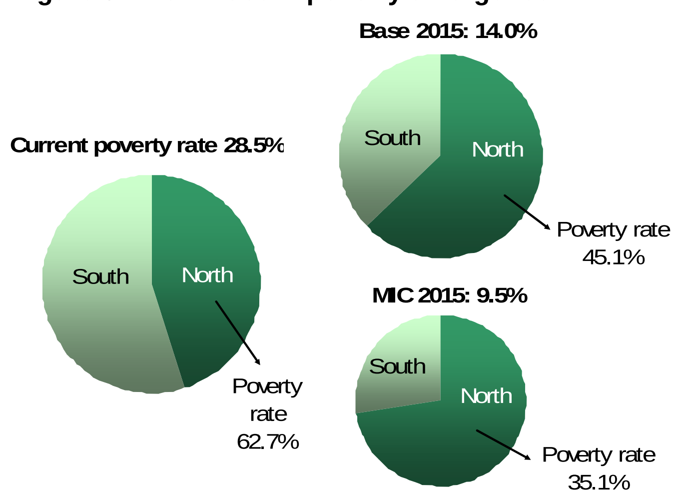
Source: Authors' calculations based Benin et al. 2007.

Poverty Reduction Remains a Challenge in the North

Past growth in Ghana has significantly reduced poverty at the national level. However, international experience suggests that countries that are on the path to becoming MICs may experience rising inequality between rural and urban areas and across subnational regions. Therefore, Ghana must pay special attention to its lagging regions and to those household groups that may be left behind in the growth process. Certain trade-offs between rapid growth and additional poverty reduction within lagging regions may exist. Model simulations show that the current growth path will lead to greater regional income divergence and further concentrations of poverty in the North (see Figure 3). While accelerated growth will allow Ghana to meet its MIC goal, the poverty rate in the North will still remain at 35 percent in 2015, except that by then, more than 66 percent of the country's poor will live in the region (compared to 45 percent today).

Compared to the rest of country, the North has fewer opportunities in either agriculture or nonagriculture. To accelerate growth in the North, greater attention should be given to activities that benefit a majority of farmers, such as cereal production and livestock. This is especially important for poorer, smaller-scale farmers. There is also the potential to develop nontraditional cash crops that are typically grown in the North. The successful development of vegetable and fruit production in the savannah zone of Burkina Faso has demonstrated such possibilities. The same is

Figure 3—North-South poverty divergence



Source: Authors' calculations based on Breisinger et al.

true for shea nuts and shea butter production and trade. Increasing interregional trade with neighboring countries provides new opportunities both within and outside of agriculture, which can foster growth and poverty reduction in the North. Promoting development in the North will allow Ghana to further reduce poverty on the way to reaching MIC status.

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