Ghana's Economic Growth Puzzle: What is to be Done?

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After 46 years of independence, Ghana is still in the economic wilderness. The sad reality is that Ghanaians are as poor today as they were at independence in 1957. There does not seem to be any light at the end of the economic tunnel, and that is largely because this country has operated under a false economic paradigm throughout most of our history. What is required is a major paradigm shift and the big question is whether we are willing to rally around the drastic policies that will free us from the economic quicksand on which we stand. Why has economic growth stagnated in Ghana?

Fundamentally, this economy has been unable to organize its institutions to mobilize the resources needed for growth. There are two pillars in a national resource mobilization system – government revenue mobilization and the financial system. In both cases, we fall seriously short.

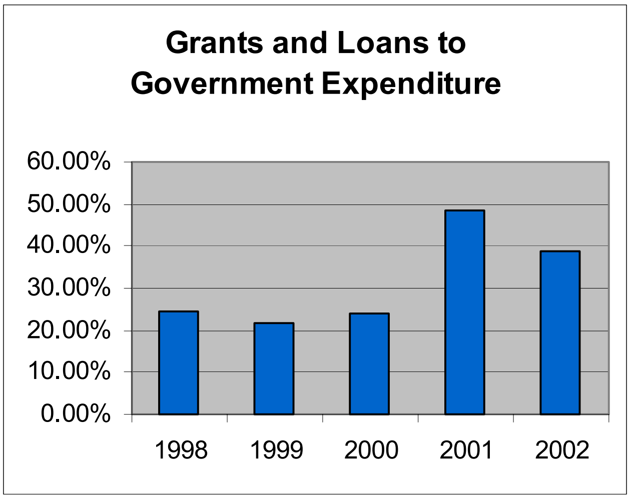
1. Revenue mobilization by the government, both at the central and local levels is inefficient. Thus, the expenditures needed to maintain government services cannot be supported without resorting to a number of undesirable practices which include:
   - begging for dollars from so called development partners who have a vested interest in our state of economic impotence,
   - printing cedis which has historically given the country one of the highest and unstable inflation rates in the world,
   - runaway government deficits financed by borrowing massively from the domestic financial markets, driving interest rates up and crowding out the private sector.

2. A weak financial system that is simply not up to the task of mobilizing and allocating savings efficiently to both the public and private sector.

As a result of our resource deficiency, the economy in its present form suffers from growth-impeding structural deficiencies. First, we are not able to provide the *hard infrastructure* that supports economic growth. These include transportation and communication infrastructure, educational facilities, health care, etc. Second and equally important is our inability to provide the needed *soft infrastructure*. The latter includes governance institutions, appropriate legal and regulatory systems and associated enforcement mechanisms. The absence of effective soft infrastructure has bred corruption and rent-seeking, further magnifying inefficiencies in allocating what little resources we have.

Instead of attacking our economic problem from the roots, we have merely played around with the symptoms. At countless economic forums and workshops, we have attempted to do a national SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis. From the National Economic Forum under the NDC through to today's National Economic Dialogue, and countless other economic brainstorming sessions, participants, including many so-called experts provide recommendations to government most of which call for government to provide more resources for this and that – health care, roads, education and many other pet initiatives. How can government allocate resources that are simply not there?

The vicious cycle of resource deficiency and low growth will persist unless we set ourselves some forceful guidelines for our economic policymaking. The ideas expressed here are not new. Rather they represent a recapture of important lessons of development that have accumulated over the last 50 years or so, which we have with surprising consistency ignored. The starting point is to free our policymaking machinery from the grip of donors. That requires a strong sense of national purpose and political will.



Policy Guideline 1: *Ghana should set itself a national goal of getting out of all official multilateral and bilateral programs within a maximum time frame of 5 years. Resource mobilization should focus on domestic resources leveraged with capital raised from global financial markets on the strength of our ability to pay.*

Our national economic priority should be to reduce our unsustainable dependence on official donors (euphemistically called "development partners"). In 1998, the sum total of official grants and project and program loans covered 25% of total government expenditure. By 2001, total official grants and loans covered 48% of government expenditures. 2002 fiscal data only show a marginal reduction in donor dependence, reflected in a 39% contribution of donors to total government expenditure. In the last five years, the lowest level of donor dependence was the 1999 figure of 22%, which may be explained by the reluctance of donors to support government in the face of the serious macroeconomic policy slippages that preceded the 2000 elections.

The notion that development can be achieved by using official multilateral and bilateral financial assistance to plug a resource gap has been shown to be false. William Easterly, a former World Bank economist, now an economics professor at New York University, in an extraordinary analysis of the flaws of the development policies followed by the World Bank reached the following conclusion:

Many times over the past fifty years, we economists thought we had found the right answer to economic growth. It started with foreign aid to fill the gap between "necessary" investment and saving. Even after some of us abandoned the rigidity of the "necessary" investment idea, we still thought investment in machines was the key to growth. Supplementing this idea was the notion that education was a form of accumulating "human machinery" that would bring growth. Next, concerned about how "excess" population might overwhelm the productive capacity of the economy, we promoted population control. Then, when we realized that government policies hindered growth, we promoted official loans to induce countries to do policy reforms. Finally when the countries had trouble repaying the loans they incurred to do policy reforms, we offered debt forgiveness. None of these elixirs worked as promised, because not all the participants in the creation of economic growth had the right incentives. [1]

Because of a blind adherence to these failed policies of donors, we have ended up with is a set of multilateral and bilateral programs that come with a slew of conditionalities that take away our policy flexibility and leave us forever shackled. By contrast, take the case of Singapore. In 1965, Singapore separated from Malaysia in difficult circumstances. Many, including the Malaysians, thought that Singapore would not survive on its own and will rejoin Malaysia one day. Lee Kuan Yew, the then Prime Minister of Singapore proclaimed that Singapore will not only work but prosper and flourish and that he will not carry a begging bowl around the world in search of aid. He didn't and Singapore today is testimony to how resources mobilized at home and can be leveraged several times with global capital obtained through the market if the right economic policies are pursued.

Mahathir Mohamad, who has just retired as Prime Minister of Malaysia evinced the fundamental soundness of the "no begging bowl" approach. According to Mahathir, "By *and large, a country should be allowed to run its own economic affairs and financial affairs. There shouldn't be pressure from outside. If people find the situation uncomfortable then they should think about want they can do, not what others can do for them. We don't ask others to do things for us, we do it ourselves…. I was born under colonial rule…I felt very small in those days. Nobody showed any respect for those under a colonial power. I would not want to go back to that stage and we must stand on our own two feet"*[2] During the 1997-98 Asian financial crisis, instead of following the prescriptions of the IMF, Mahathir decided to chart his own course. He was treated with scorn when he decided to introduce currency controls. Subsequent events showed that he had the right prescription. His policies worked incredibly well and protected the economy. Malaysia's was able to recover faster than most of the countries hit by the crisis and the IMF had to eat humble pie.

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[1] William Easterly (2002) The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics, Cambridge, Massachusetts: the MIT Press
[2] Euromoney, October 2003, Dr. Mahathir's Alternative Therapy" pp.42-48

In a recent study of the impact of prolonged use of IMF loans[3], the IMF's own Independent Evaluation Office concluded that prolonged use of IMF facilities does present a number of problems such the following:

- It hinders the development of robust domestic policy formulation processes over time
- There is an inherent tension between the quasi permanent conditionality implicit in prolonged use and country "ownership"
- The perception that IMF resources would be available over the long term, despite policy slippages, may weaken incentives to take decisive action to deal with the underlying adjustment problems

Since 1983, Ghana has negotiated 10 facilities with the IMF and received an IMF disbursement in 17 out of the last 20 years. To be fair, there are other more chronic users of IMF facilities than Ghana. The most chronic users during the period 1971-2000 in terms of number of arrangements include the Philippines (16), Panama (17), Senegal (13) and Kenya (13). However, Ghana is not that far behind. Prolonged use tends to be very persistent as very few countries graduate from such use. The cases of Morocco and Jamaica, two countries that have exited from IMF programs, are quite revealing. After a series of nine Fund arrangements starting in 1980 Morocco exited from Fund programs in 1993 and completed paying its borrowing from the IMF in 1997. In the case of Jamaica, it had had 14 arrangements with the Fund since the 1960s. The last program expired in March 1996 after which the Jamaican government announced its "independence from the IMF". In both cases, better policy ownership enabled government to achieve sustained economic reform without official Fund programs. Jamaica, for example has managed to maintain large primary fiscal surpluses, involving some difficult budgetary decisions.

Many countries have at various stages of their development made a conscious effort to avoid the donor stranglehold. They include Singapore, India, South Africa, Thailand and Botswana. We should aspire to belong to this group of countries. It is only by getting out of donor dependence that we can seriously focus on establishing the structures that will enable us to mobilize sustainable resources, both domestically and internationally using the innate strength of our economy rather than playing up its weaknesses to elicit donor sympathy. The one advantage with using capital raised from global financial markets is that you maintain your policy flexibility within the framework of market discipline. Capital raised commercially through the capital markets is priced on the basis of sovereign risk and preserves policy flexibility. More importantly, it accelerates the process of integrating domestic financial markets with global markets, with very strong spin-off effects for private sector firms wishing to raise capital internationally.

Relying on donors has been a vicious trap. We borrow to the point where we are unable to pay, ask for forgiveness, borrow again and the cycle continues. We have seen cycles of debt forgiveness: Cologne, Toronto, and Naples terms of the Paris Club and HIPC. We however continue to borrow and we have never as a country had a credible debt

[3] Independent Evaluation Office, IMF (2002) "Evaluation of the Prolonged Use of IMF Loans" www.imf.org/ieo

sustainability policy. The vicious cycle of debt is bad enough but even worse is the policy inflexibility that we lock ourselves into because of donor relationships. Our economic management lacks consistency and creativity, having been reduced to adopting boilerplate policies which are handed down by donors as conditionalities.
This vicious cycle is perpetuated by a symbiotic relationship between our civil service and the bureaucracies of the donor agencies who have jointly acquired a vested interest in the status quo. The bureaucracies survive by developing programs which are handed down as conditionalities, which they then have to monitor during implementation. As implementation ends, a new program is hatched. This is how we end up with successive projects: Urban 1, Urban 2, FINSAC 1, FINSAC II, NBFI, PRCS I, PRSC II, etc. Our government ministries, departments and agencies have decayed from policymakers to managers of donor-funded projects that come with the power to control the disbursement of large pools of funds.

We should of course be happy to work with donors who want to share in our aspirations. But this should not take place within the context of official programs negotiated with government. Donors should be free to work with private organizations such as NGOs, if they can identify a common interest but in the new paradigm.

The obvious question is: How are we going to replace the support which we are currently getting. The obvious answer is to dramatically increase domestic resource mobilization. This brings us to the next Policy Guideline.

Policy Guideline 2: *There can be no development unless all Ghanaians are made to bear their fair share of contribution to the resources needed for growth. If one person pays, everyone must be made to pay. This should be the guiding principle of government revenue mobilization.*

Our revenue collection machinery needs to be revamped. We have played around with the problem at the margins. We need to invest massively in our revenue agencies. Currently, revenue agencies are allowed to retain 2% of the taxes they collect to support their operations. But the system is simply not working. The lack of qualified personnel and heavily manual systems mean that it is operating well below the level needed to attain the revenue levels needed to support the economy. Like a typical business, we should invest heavily in areas where the return on investment is highest. The revenue agencies fit this description at this stage of our development.

I remain convinced that Ghana can mobilize enough resources domestically if we give it the priority it deserves. There are many sources of untapped resources that we simply have not accessed. Part of the problem is that Ghana's elite, which has historically controlled political power, has for decades managed to design and maintain a system that protects their private wealth and high standards of living. The instances of this unfair subsidization of the rich are many. For example, let us look at the property rate system that we operate in Ghana. We have houses at Airport Residential, Cantonments, East Legon, etc that have values of $400,000 and upwards. How much property tax do the owners pay? In a typical developed economy, property taxes are usually about 1-2% of the value of the property. By this reasoning, most houses in the expensive areas of Accra should be paying minimum property taxes of about $4,000 per annum or about ¢35 million. Instead many such property owners are paying amounts well below ¢500,000 ($60) annually. As low as these amounts are, there are some unscrupulous members of society who will still bribe assessors to reduce the valuation of their properties so that they pay less. The low level of taxes encourages the building of large houses. Many people erroneously think that large houses are investments because they appreciate in price. This is unfortunately false. A principal residence cannot be an investment because it is unlikely to be sold. Proper taxation of real property will be a disincentive for building large houses and will free up huge amounts of capital for investment in more productive assets.

Many other ridiculous fee structures exist in the system. For example, it is difficult to understand why it only costs only ¢500 to use the Tema motorway and the Akosombo road. Even if we measured this in terms of affordability, we can show that while the fee for a similar toll route in say North America will be about .03% of per capita income, the fee in Ghana is .01% of per capita income.

Policy Guideline 3: *We will mobilize more resources by focusing on strengthening the mechanisms that bring all Ghanaians into the formal economy.*

In the "Mystery of Capital"[4] Hernando de Soto establishes that in the poor countries of Asia, Africa, the Middle East and Latin America, the assets of the poor amount to 40 times all of the foreign aid received throughout the world since 1945. However, these resources are held in defective forms – land whose ownership rights are not adequately recorded, unincorporated businesses with undefined liability, etc. "*Because the rights to these possessions are not adequately documented, these assets cannot be readily be turned into capital, cannot be traded outside the narrow local circles where people know and trust each other, cannot be used as collateral for a loan, and cannot be used as a share against an investment….Without representations, their assets are dead capital"*.

We are led to the obvious conclusion that the resources for development exist in large quantities among the poor in Ghana, who constitute the majority of the population. What we lack are the representational forms to mobilize these into capital for development. In fact, De Soto characterizes a developing country as a country where "*nobody can identify who owns what, addresses cannot be easily verified, people cannot be made to pay their debts, resources cannot be turned into money, ownership cannot be divided into shares, descriptions of assets are not standardized, and cannot be easily compared, and the rules that govern property vary from neighborhood to neighborhood or even from street to street"*.

How do we bring our poor into the formal system so that their assets can be translated into capital for development? There are bottlenecks to establishing legality and

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[4] Hernando De Soto (2000), The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else, New York: Basic Books

formalization that need to be removed. Some specific investments that have to be made include:

- We need to document all Ghanaians into a national database that provides an effective tracking system. Fortunately, we have made a good start by introducing the Taxpayer Identification Number. Hopefully, we will soon have the National Identification Card for individuals.
- Establishing systems for identifying where people live. This is a monumental task but we can start small and start NOW.
- An investment in the Registrar-General's Department, to make it accessible throughout the country will provide returns not only in the form of higher tax revenues but also in the ability of small entrepreneurs to finance their business operations and thus be able to access capital. Businesses that are not registered cannot be taxed. But even if businesses being brought into the formal system have to pay taxes, it can be argued that for many businesses in the informal sector, the benefits of being registered and paying tax may be higher than the cost. A business that is properly registered has a better chance of securing credit because it is documented and can be traced; it does not have to continuously bribe to avoid being detected. The challenge is to design a system that on balance convinces those in the informal sector that they have more to gain by being part of the formal economy.
- Simplifying processes for securing title to real estate means that real estate asset can be transformed into capital because they can be pledged as collateral and transferred for cash relatively easily.

Investments made in formalizing the economy will produce returns in resource mobilization far in excess of what it costs. Indirectly, we minimize the cost of wrong policies and inflexibilities, associated with donor dependency.

Policy Guideline 4: *The financial sector is the second pillar of a sustainable resource mobilization system. Only a sound financial system will mobilize and allocate financial resources efficiently and sustainably.*

The role of the financial sector is to mobilize and allocate savings. When the function is effectively being discharged in an economy, those with surplus funds are motivated to save and those requiring funds for investment purposes are able to access the savings. This takes place with the support of an array of intermediary institutions such as banks, insurance companies, securities companies, non-bank financial institutions as well as a regulatory framework that establishes and enforces the ground rules such that all participants receive fair treatment. Symptoms of a financial system that is not working include the following:

- Savers would rather keep their surplus funds at home or acquire real assets rather than deposit their funds with formal savings vehicles such as bank deposits and securities.
- Savers are only interested in holding short-term assets

- Good projects are not financed because lenders are unwilling to bear the risk of lending
- Lenders are only willing to lend for short periods of time

All of the above symptoms of failure exist in Ghana. Market failure occurs when free markets, operating without any government intervention, fail to deliver an efficient allocation of resources.

The existence of market failure requires special interventions to improve the mobilization and allocation of capital. Nobel laureate and former World Bank chief economist, Joseph Stiglitz, in a recent article "Hypocrisy and the Free Market"[5] has noted that many countries, including those that are today acknowledged as having sound financial systems recognized the need to develop appropriate policy responses to market failure during the early stages of the development of their financial sectors. Many such responses have persisted to this day and continue to complement the free market even today. How else do we explain publicly sponsored financial intermediation mechanisms such as Fannie Mae, Ginnie Mae, Sally Mae, the Small Business Administration, Eximbank of the United States; or the Business Development Bank or the Canada Mortgage and Housing Corporation? Many of these state sponsored financial institutions have been instrumental in growing small companies that eventually became global players such as Federal Express. The fact that the United States boasts one of the highest home ownership rates in the world is clearly due to that fact that federally supported lending structures have been put in place to cheapen mortgages to levels of affordability unequalled anywhere in the world. These are illustrations of state-sponsored financial intermediation being used to achieve desirable social policy outcomes. Yet, we find the ironic policy twist reflected in the hypocritical opposition of development partners to state intervention in financial intermediation, a clear case of "preaching what you do not practice".

Consistent with the policy inflexibility that results from donor dependence, we have shied away from targeted state interventions that would have supported our efforts to jump-start our march into a modernized financial system. FINSAP, was largely designed to get the state out of the financial sector, and rightly so in the instances where state role had been shown to be a waste of resources, such as state-owned banks that developed a culture of imprudent lending. However, we have thrown the baby away with the bathwater by completing abandoning the state's role in resolving financial market failure. For example, the state does not have a coordinated Small and Medium scale enterprise (SME) finance. With benefit of experience, targeted interventions can be made in the financial sector. These include:

- Strengthening our traditional state-sponsored development finance institutions such as the Agricultural Development Bank to be provide better development support to the agricultural sector, particularly in the provision term loans for farm investment. Such institutions should be funded through non-deposit sources and therefore freed from the rigors of central bank supervision.

[5] Joseph Stiglitz, "Hypocrisy and the Free Market", Business Day, October 21, 2003

- Establishing new development finance institutions with public resources with adequate safeguards to provide loans and loan guarantees to the SME sector. The rapid growth of the private sector in Asia has been largely fueled by state-promoted financing of the SME sector. A central SME loan guarantee facility has been central in most successful SME support schemes. Learning from our prior experience, we need to tighten up our monitoring and provide appropriate incentives to those who are put in charge of such institutions
- Using legal mechanisms to reduce interest rate rigidity. One way of achieving this is to enforce a pass-through of interest rate changes within the banking system thus providing the right market incentives to borrowers and savers.
- Providing appropriate interventions in the housing finance sector to stimulate mortgage lending and securitization of mortgages

It is important to note that the conditions that will increasingly formalize the economy are the same conditions that will systematically reduce market failure in the financial sector and reduce the need for targeted public interventions. Market failure in the financial sector occurs because the participants do not trust each other. In particular, because of a lack of formal identifications systems and information bases, lenders will not lend to borrowers at any price. A financial system has to be underpinned by important formal representations such as identification systems, formally registered businesses and clear property titles.

Conclusion

There is consistency among the causes of our economic impotence. Instead of focusing on the activities that will promote a sustainable resource base, we expend our energies on attracting unsustainable resources, mainly multilateral and bilateral aid. As a result, we are forced to implement policies that further take us away from a more efficient resource mobilization and allocation path. We are unable to apply targeted interventions to jump start our financial system because of donor resistance to state participation in financial intermediation. We miss the critical measures that will turn our fortunes around such as investing adequately in our revenue mobilization mechanisms and establishing the systems that will formalize economic participation, thus broadening the net for resource mobilization. Bold steps are needed to take us out of this vicious cycle into a virtuous cycle in which strong domestic resource mobilization leveraged in international financial markets provide better hard and soft infrastructure, expand the resource base even more and move us onto a higher trajectory of resource mobilization and development. This is what is to be done. Are we ready?