Trade and Exchange Rate Policies since Independence and Prospects for the Future

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Abstract

Ghana started off as a country well-endowed with natural resources with a lot of hope that she was going to be a success in the years after independence. The belief of the leaders after independence was that the capitalist mode of development was not appropriate and that socialism was the way to go. Thus the state was involved heavily in critical sectors of the economy and allocative decisions by policy makers took precedence over the price mechanism. The import substitution root to industrialisation was followed. Success however proved elusive and some 25 years after independence the economy had virtually collapsed on the heels of poor performance in the external sector which has been attributed to among other things poor economic policy. Economic Recovery and Structural Adjustment programmes were instituted from 1983 onwards, with trade and exchange rate reforms being key aspects of the reforms. Economic performance improved but challenges have remained. It has been difficult to ensure macroeconomic stability and to remove supply bottlenecks which have made the export sector uncompetitive and job creation difficult. The recommendation is to deal with these challenges and continue with the more market oriented policies in order to take advantage of an increasingly globalised world.

Keywords: Trade policy, exchange rate policy, competitiveness, import-substitution, economic recovery programme.

1 Introduction

Ghana’s economy is a small open one. The trade intensity index was about 50% at the time of independence. That makes the external sector very important and crucial for the performance of the economy as a whole. Development models normally regard the external sector as one that can trigger and enhance development. Many countries have been able to improve their developmental status by riding on the heels of good performance in the trade sector. Good performers such as Japan and the Asian tigers all had robust external sectors which propelled them to attain heights unforeseen in their history. More recently China has achieved spectacular growth which has enabled her to become the second biggest economy in the world as a result of excellent performance in the trade sector.

The exchange rate can be said to be a super price in an economy. It links a country’s economy to the rest of the world through both macroeconomic and microeconomic channels. Every country that wants to take full advantage of the benefits offered by trade must ensure that she is competitive and one important ingredient in this competitiveness concept is an appropriate exchange rate policy.

Ghana started off as a country well-endowed with natural resources with a lot of hope that she was going to be a success in the years after independence. This was coupled with the fact that in Kwame Nkrumah, her first president after independence, she had a leader who was...
passionate about lifting his people from poverty\textsuperscript{1}. Success however proved elusive and some 25 years after independence the economy had virtually collapsed on the heels of poor performance in the external sector which has been attributed to among other things poor economic policy\textsuperscript{2}. Then came a period of harsh measures including trade and exchange rate reforms that restored some decent performance to the economy. This chapter looks at trade and exchange rate policies, both crucial to the performance of the external sector over the years and assesses the effect of these policies on the external sector in particular and the economy in general. We then analyse the lessons that can be drawn from the experience.

The chapter begins with a look at the economic policies adopted after independence and before the reforms and an analysis of the results of those policies. Following this we look at the economic reforms with special emphasis on exchange rate and trade policy reforms. The section ends with an analysis of the results of the reforms. The last section looks at the challenges and the way forward.

2 Economic Policy before Reforms

2.1 Nkrumah’s Broad Economic Policy

Generally policy was influenced by colonial experience which was seen as exploitative and thus not a model Ghana could follow. Nkrumah had long believed in the socialist mode of economic governance and it was natural for him to follow this direction as the alternative to the British model. To reinforce these ideas most development economists of the era were in agreement that there needed to be massive government involvement in the economy to jump-start the development process\textsuperscript{3}.

The policy Nkrumah pursued after independence in 1957 was driven by three basic objectives: 1) to pursue the socialist mode of economic governance; 2) to achieve economic independence; and 3) to modernise the country quickly (Killick, 2010). These three objectives were self-reinforcing and resulted in the kind of strategy that required the primacy of the state in directing affairs. The private sector he felt was too weak and lacked the necessary resources and entrepreneurial ability to transform the country.

Nkrumah also embarked on massive infrastructural projects that used both domestic and foreign funds. He had inherited reserves worth more than a year’s imports and these were used liberally to achieve the ambitious goals (see Killick, 2010 pp. 109).

2.2 Trade and Exchange Rate Policy under Nkrumah

Between 1950 and 1961 Ghana’s payments regime was a liberal one with virtually no restrictions. The minimal restrictions that existed were related to trade with nations outside of the sterling area. This period saw the accumulation of reserves following the commodity boom associated with the Korean War and the gradual drawing down of the reserves (Leith, 1974).

Once Nkrumah took on the reins of policy, the price mechanism increasingly took a back seat to decisions on allocations by technocrats and bureaucrats. He rejected the principle of

\textsuperscript{1}See CPP, 1962.
\textsuperscript{2}See for instance Killick, 2010.
\textsuperscript{3}See Paul Rosenstein-Rodan, 1943.
comparative advantage because its application would have resulted in a slower growth of manufactures and a continued reliance on primary production (Killick, 2010 pp.202). This was reinforced by recommendations emanating from the Prebisch-Singer thesis which showed the dismal prospects for continuing to expand the production of primary products. The option adopted was then to pursue the import-substitution route to industrialization. Many developing countries from Asia and Latin America had already embarked upon this strategy based upon similar reasoning and also a strong desire for self-sufficiency and economic independence (see Little et al., 1974 pp. 2). With regard to exchange rate policy the Nkrumah era was the period of fixed but adjustable rates of the Bretton-Woods system. Many developing countries, including Ghana frowned on devaluation, regarding it as stagflationary. The preferred option then was to use alternative measures such as monetary and fiscal policies in addition to restrictions to deal with imports.

An economy such as Ghana’s that needed to be transformed needed to build up its capital which had high import content. Also production of consumer goods required imports of raw materials and other inputs. Thus import needs were likely to grow at least as fast as domestic production. This would increasingly put a strain on exports to supply the needed foreign exchange. Given structural difficulties involved in expanding exports, the balance of payments came under severe strain. As the balance of payments deficit grew the policy adopted in Ghana was to limit imports of consumer goods in general and especially those which could be produced locally with increasingly high tariffs and quotas. This was buttressed by running down of the foreign exchange reserves coupled with the use of medium-term suppliers’ credit (Killick, 2010 pp. 103). Officials administered the available foreign exchange and the level and distribution of it were based on estimated foreign exchange availability and perceived national needs. These national needs included industrialization, import substitution and diversification of trade towards the Eastern Bloc (Leith, 1974 pp. 7).

The hope of Nkrumah and his policy advisors was that the newly established import-substituting industries would become more productive and thus save foreign exchange. However, this was not to be and the countries that had earlier embarked upon the import-substitution strategy had already realised that the time-lag involved was much longer. Thus import substitution worsened rather than improved the balance of payments. Little weight was placed on efficiency considerations in the setting up of industries. Steel (1972) for instance, found that in 1967/68 about a quarter of manufactured output was undertaken at a net loss of foreign exchange.

More and more desperate measures were taken to contain the situation. In addition, many of the enterprises set up to pursue the strategy performed poorly and thus drained the state of resources as many had to be bailed out continually (see Killick, 2010). To make matters worse, world prices of cocoa collapsed in 1965 partly because Ghana as a major producer expanded her output greatly. As the crisis deepened the idea of devaluation was not seriously considered. Rather, controls were tightened which inevitably led to corruption as a lot of

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4The Prebisch-Singer thesis concluded that there was a tendency for raw material prices to fall relative to that of manufactured goods. One of the remedies proposed was for producers of raw materials, largely developing countries to initiate industrialization through the import-substitution route. (see United Nations, 1964 and Singer, 1950)

5Countries such as Brazil, Mexico, India and South Korea had just embarked upon the strategy.

6See for instance Cooper, 1971.
discretion was given to officials who subsequently misused their positions. There was also a rapid accumulation of short-term debt so that at the time of the 1966 coup total debt amounted to half of GDP and there were no substantial lines of credit (see Killick, 2010).

2.3 Policies after Nkrumah

Meanwhile high domestic inflation resulted in increasing overvaluation of the cedi which tended to penalise exporters. Despite a devaluation in 1967 after Nkrumah was overthrown, the effective exchange rate for imports has been calculated at $1.35 to $1 in 1969 while that for exports was $0.7 to $1. The official exchange rate at the time was $1.02 (See Leith, 1974 pp. 11-13). The military government that overthrew Nkrumah subsequently handed over power to a civilian regime led by K. A. Busia in 1969 who like the military government had a liberal, free market stance. The payment system however, remained unsustainable and the Busia government was left with only two options – seeking debt relief and/or a massive devaluation. Very little debt relief was forthcoming and the government devalued the currency by a massive 80% in December 1971. This devaluation led to a big jump in prices of imported goods and consequently the general price level. This proved unpopular and the government was toppled by a military coup in January 1972. The new government revalued the currency and this resulted in a smaller overall devaluation.

Having overthrown the Busia regime for devaluing the cedi, any adjustment of the currency downwards was more or less off limits politically. Thus adjustment had to take place elsewhere. Theoretically any credible regime in which the exchange rate could not be adjusted has to have some internal flexibility of prices to respond to shocks. However while nominal prices can move upwards, downward movement especially when it involves wages is politically difficult. Consequently Ghana entered into a kind of vicious cycle in which the trade policies penalised exportation that further reduced foreign exchange earnings, which in turn worsened the balance of payments, which required even more stringent controls.

As performance in the trade sector plummeted many of the industries that had been set up under import substitution were starved of vital inputs because of foreign exchange shortages. Capacity utilisation fell drastically and employment stagnated. State enterprises that had been set up in all sectors continued to perform poorly and the government ran out of funds to bail them out. In 1978 the cedi was adjusted from $1.15 to the dollar to $2.75 to the dollar. This was the biggest devaluation the country had seen but it was regarded as too little, too late. The black market rate of the dollar was hovering around $60 (Leechor, 1994). Thus the export sector continued to be squeezed. By the start of the reforms the percentage of the world price received by cocoa farmers had fallen to as low as 25%. It was even in single digits if assessed at parallel market rates (see Sarris and Shams, 1991).

Controls normally go with corruption and this became rampant as the economic situation worsened. Between 1970 and 1983 per capita income fell by 30% (World Bank, 1984). This state of affairs led to another coup in 1979 after which some of the leaders of the old regime were executed for corruption. The military handed over power quickly to a civilian administration after three months only for them to return in 1981 as the civilian government appeared unable to deal with the continuing crisis. When the military seized power in December 1981 it ‘declared its intention to confront international capital/imperialism and its

7The level of corruption in the era is well documented. See for instance Ministry of Information, 1967.
8The price quotation index is used in the definition of the exchange rate and this means the price of the dollar went up by 80%.
perceived hold on the Ghanaian economy.’(Gyimah-Boadi and Jeffries, 2000 pp. 41) Such a stance was not favourable to bringing in the World Bank or IMF and certainly against any devaluation of the cedi. The focus then was to mobilise internal resources and appeal to the patriotism of workers and students. This stance continued into 1983 without any improvement in the economy and to aggravate the situation severe shocks such as droughts, repatriation of some one million Ghanaians from Nigeria and bush-fires occurred. It became increasingly clear that some form of external assistance was needed to get the country out of the economic mess. Expectations of help from Libya and the Eastern bloc did not materialise. Finally the regime had to turn to the IMF but not without resistance from within its own ranks (ibid, pp. 44). Ghana then embarked on the Economic Recovery Programme (ERP) in 1983.

2.4 Analysis of Results of Policy before Reforms

Various reasons have been given for the dismal performance before the reforms. These include adverse external shocks and political instability. The most credible reason though is poor economic policies as detailed in Killick (2010) and Leith (1974). Policies that limited the workings of the price mechanism have been particularly cited. Of particular importance here is exchange rate policy. Other studies have run regressions which try to assign growth in Ghana’s economy to various variables. For instance Tutu and Oduro (1999) studied liberalisation episodes in Ghana since 1960 and tried to find out whether liberalisation did cause an improvement in economic performance. One of the most significant results came when they ran regressions explaining the volume of exports and imports from 1960 to 1990. In the export equation were variables such as lagged export volumes, the real exchange rate, real income, import volumes, bias in the trade regime and the black market premium. The only variables that were significant with the correct signs were the real exchange rate, the black market premium and the lagged dependent variable. The import demand equation had real income, international reserves, the real exchange rate, the black market premium and the bias in the trade regime as explanatory variables. The only variable that had the expected sign and was significant was the black market premium, which is an indication of misalignment.

Fosu and Aryeetey (2008) cite a study by Ndulu and O’Connell (2003) which estimates a model of growth for some African countries. For Ghana they identified the decade of the latter 1970s to the early 1980s as being characterised by substantially negative growth rates. Their results showed that policy as exemplified by the overvaluation of the domestic currency seems to have been a major culprit in Ghana’s underperformance during the period. Laryea et al. (2015) showed using a growth equation that exchange rate misalignment was particularly detrimental to growth. Its negative effect was even stronger than that of adverse external shocks.

3 The Economic Recovery Programme

There were two broad goals of the Economic Recovery Programme (ERP) in Ghana. First was the restoration of economic balance and second was the laying of the foundation for sustainable growth with equity. This involved four broad objectives/components. These were 1) a stabilisation component aimed at reducing inflation and moving towards a trade deficit consistent with available financing; 2) a series of micro and institutional reforms aimed at correcting price incentives and increasing integration of Ghana’s economy into the world economy; 3) rehabilitation of the physical and social infrastructure; and 4) a removal of impediments to the expansion of private investment. Important flows of external aid, soft loans and credit supported the reforms (Corbo and Fischer, 1995).
3.1 Exchange Rate Reforms

The exchange rate was a very visible symbol of the large distortions in the Ghanaian economy and tackling this particular problem was thus a central part of the whole liberalisation process. The government needed to restore incentives for the production of exports and to ensure an increase in the overall availability of foreign exchange. Furthermore, it wanted to improve foreign-exchange allocation and channel it into selected high priority areas. To pursue these broad goals the government had four main objectives: First, to realign the official exchange rate, second to achieve a convergence of official and parallel rates, third to absorb the parallel market into the legal market and fourth to allow demand and supply to determine the rate and allocation of foreign exchange (Dordunoo, 1994).

To achieve the first objective, a straightforward devaluation was perceived by some to be politically damaging given events of the past. Thus the whole process was done gradually and in three steps. The first step retained the official rate of ₦2.75 to $1 but instituted a system of bonuses and surcharges for exports and imports, respectively, in 1983. Thus bonuses were given to exporters that differed according to what was being exported while surcharges were imposed on importers according to what they imported. This in effect constituted a devaluation which resulted in a multiple exchange rate regime. In effect traditional exports and imports of crude oil, essential raw materials, basic foodstuffs and capital goods were subject to a rate of ₦23.375 to $1. The rate for non-traditional exports and other imports was ₦29.975 to $1. In the second step, the official rate was changed six months later to ₦30 to $1 to replace the system of bonuses and surcharges and in effect unify the rate. The third step involved a series of fairly large devaluations until in January 1986 the rate stood at ₦90 to $1.

The second objective involved a series of measures aimed at moving towards a market determined rate. First a retail foreign exchange auction market for selected transactions was introduced. Further, an official two-tier system was introduced whereby imports and exports of selected goods were subject to the official fixed rate while the remaining two-thirds of Ghana’s external transactions were subject to this auction rate. This two-tier system was unified in February 1987 at ₦150 to $1 with all transactions being settled at the weekly auction rate.

The third objective of the reform process began in February 1988 when the parallel market was legalised with the granting of licenses to individuals to operate foreign exchange bureaux. The main aim of allowing the operations of such bureaux was to attract additional foreign exchange to official channels. Other aims were to facilitate the acquisition of small amounts of foreign exchange on a daily basis and to bring about convergence between parallel and auction rates (Oduro and Harrigan, 2000). Thus the rate was now wholly a market determined rate. Subsequently a wholesale market auction was introduced in 1990 to be replaced by an inter-bank market in 1992. With these changes the gap between the inter-bank rate and the parallel rate was largely eliminated.

The fourth objective involved maintaining the flexible exchange rate regimes that had been established. The year 2006 saw the passing of the foreign exchange Act 723. This Act substantially liberalized current account transactions. Capital account liberalization has however not been achieved.
In view of the fear many governments had about the inflationary impact of devaluations, Younger (1992) made a study using data from 1972 to 1985 to capture the devaluations that took place from the late 1970s to the mid-1980s. The paper’s main conclusion is that devaluations in Ghana have had a small but statistically significant impact on the domestic CPI. For a 100 per cent increase in the exchange rate, prices rise by 5 to 10 per cent. The paper’s conclusion then is that given the extensive restrictions and controls in place at the time of the devaluations, prices were already largely reflecting parallel market rates and thus fears of serious inflation accompanying devaluations were unwarranted.

3.2 Trade Policy Reforms

Broader trade policy reforms to reinforce what took place with respect to the exchange rate included tariff adjustments, import liberalization, deregulation of domestic market prices and controls and institutional reforms that particularly affected the revenue generating bodies.

The government gradually boosted cocoa prices from 25% of the world price to well over 60% by 2000. Also, private participation in the purchasing and haulage of cocoa was introduced as was a more favourable investment climate for investors. More robust export promotion policies were undertaken. The main exports over the years have remained cocoa, timber, gold and other minerals and during the 1990s the government made a lot of efforts to widen this narrow base of exports. Oil was discovered in commercial quantities in 2007 and production and exports started in late 2010.

There was a steady downward adjustment of tariff rates. With the process of reforming the exchange rate system to a market determined rate largely completed in 1988, the import licensing scheme which was considered redundant was abolished and was replaced with a special tariff on imports. Further liberalisation occurred in subsequent years and currently the tariff structure comprises four bands of 0%, 5%, 10% and 20%. Finished/consumer goods attract the highest rate of 20% while raw materials and intermediate goods are either zero-rated or attract a tariff of 10%. At the present time Ghana does not maintain any export subsidies nor does it maintain any trade-distorting domestic support. The leaders of the Economic Community of West African States (ECOWAS) adopted a Common External Tariff (CET) in 2013 and following a successful passage of the CET Act by parliament Ghana is to start full implementation on February 1, 2016.

In 2004 a new trade policy document was adopted in Ghana. This Policy was set within the context of Ghana’s long-term strategic vision of achieving middle-income status by 2012 and becoming a leading agro-industrial country in Africa (Government of Ghana, 2004). The policy which is designed to be consistent with World Trade Organisation rules provides clear and transparent guidelines for the implementation of Government’s domestic and international trade agenda. It is also designed to ensure a consistent and stable policy environment within which the private sector and consumers can operate effectively and with certainty. This policy emphasized two parallel strategies: 1) an export led industrialization strategy, and 2) a domestic market led industrialization based on import competition. These new strategies are supported through the promotion of increased competitiveness of local producers in domestic and international markets based on fair and equal competition and by introducing an import and domestic trade regime which promotes and protects consumer interest.
3.3 Results of the Reforms

The results of the reforms have been quite impressive in Ghana as seen in Figure 1. There has been a definite improvement in real per capita income growth since the reforms. It has averaged about 3% over the period with a spike registering in 2010 mainly due to the beginning of oil production. Also the economy has been more resilient to shocks. Severe terms of trade shocks occurred in 1999/2000 without that affecting growth significantly.

*Figure 1: Growth of Per Capita GDP for Ghana, 1961-2013.*

There has been a substantial improvement in the trade sector. Cocoa production doubled between 1983 and 1989 even though world prices fell by over 50% during the period. There was an eight-fold increase in gold production between 1986 and 1998. The proportion of non-traditional exports jumped from 15% to over 25% suggesting that its growth was even higher than that of the traditional exports. The trade intensity index which had been falling since the late 1960s reached a low of 10% in 1983. It then rose steadily with the reforms and has been consistently above 60% since 1987. It reached a peak of about 120% in 2001 although it has now settled to about 100% (Figure 2).

*Figure 2: Share of total Trade in GDP (%), 1961-2013.*

Source: Authors’ construction based on data from WDI, 2014.
While exports have increased, imports have increased by more so that since the reforms when there was some balance the trade deficit has expanded (Figure 3). Ghana has become more of an import dependent economy with very few local substitutes for many of her imports. This is partly the result of the import substitution strategy’s inability to create industries of reasonable efficiency thus leading to the demise of many that could not stand the competition generated by the reforms. Utilization of modern technologies and the consequent rise of productivity have been slow.

Figure 3: Trade Deficit as a percentage of GDP, 1961-2013.

With the reforms came an inflow of capital mainly in the form of concessional loans. This led to a steady increase in the debt stock from 20% of gross national income to a peak of 130% in 2001. Ghana however took advantage of debt relief under the Highly Indebted Poor Country (HIPC) initiative to reduce her debt stock substantially to 20% by the HIPC completion point in 2006. It has seen a steady increase since then.

4 Challenges and the Way Forward

The reforms finally freed the currency to be determined by market forces. There is however still a strong political constituency for having an overvalued currency in an import dependent economy such as Ghana’s. For exporters, so long as some profit margins exist a depreciation must of necessity increase it. Even if a good proportion of the inputs are imported domestic costs cannot increase by more than the world price in domestic currency. The problem in Ghana however is that a depreciation immediately results in an increase in imported input prices while the world price in domestic currency is not realised by domestic producers immediately. This is the case for instance in the cocoa industry where prices are set and not adjusted for a considerable period of time in spite of depreciation. This erodes profit margins and in some cases might wipe them out altogether.

The importance of this point derives from the fact that a depreciation should have gainers and losers. Importers lose in principle because of higher prices in cedis but exporters and those that compete with imports potentially gain. From a political economy point of view and from Ghana’s history it is predictable that importers will not be happy with a depreciation. At the
same time exporters and those that compete with imports should be happy but because traditional exporters especially do not see the gains immediately but only see increased costs, they may also agitate against depreciation. Thus we have a situation in Ghana in which there is overwhelming agitation against depreciation from both losers and potential gainers and may force politicians to take harmful panicky measures to stop the slide. This kind of situation has hurt Ghana in the past. This actually happened in 2014 when the Bank of Ghana adopted what one might call panicky measures to stem a steep depreciation.

Two broad policy goals can be pursued to deal with this temptation without causing too much damage to the economy through currency overvaluation. These are 1) macroeconomic stability through fiscal discipline, and 2) microeconomic efficiency. There have been challenges though in this respect.

The government has had serious challenges maintaining macroeconomic stability mainly because of budget imbalances. Ghana returned to civilian rule in 1992 and with it came a competitive political system. The drive by parties to win power led to a situation in which incumbent governments increased expenditures in election years – an indication of what has been termed the political business cycle. Thus each election year has seen large budget deficits which culminated in macroeconomic imbalances. Such imbalances put downward pressure on the exchange rate. Large subsidies continue to be placed on utilities and fuel. These are politically popular but economically damaging. Thus fiscal discipline which was achieved before the return to democracy has been considerably weakened. There is a need to enhance revenues through increased taxes but Ghana has a very large informal sector which is difficult to tax. Some 80 percent of workers are in this sector and some strides have been made to tax them but the situation is far from ideal and a significant amount of income still goes untaxed. The second major challenge is ensuring microeconomic efficiency. The basic idea is to have a free market economy in which economic agents such as firms and labour will increasingly respond to incentives provided by a price mechanism. As indicated earlier price controls and other restrictions were removed. However there are many other ingredients that would make a market system work. These include physical infrastructure such as transport networks and reliable utilities such as good power supply. Having adequate availability of these minimises the cost of doing business and makes the economy more competitive. This would also put less pressure on the exchange rate as exporters and producers of import competing goods respond to a depreciation. However, as a result of the dismal economic performance for the 15 years prior to the reforms there was a huge infrastructural deficit. Substantial inflows occurred especially from bilateral and multilateral agencies which were used partly to deal with this deficit. In addition it is imperative to have adequate foreign exchange reserves to smooth volatilities in the exchange rate. The aim should be to ensure a soft landing but not to prevent exchange rate movement altogether.

Ghana was able to reduce her debt burden substantially with the HIPC initiative, but debts have started growing again. The debt to GDP ratio has risen steadily since the completion point of HIPC in 2006 (Figure 4). According to the 2016 Budget Statement it is 69.12% as of September 2015. A good proportion of the debt lately is in Euro-bonds and the yield on Ghana’s bonds is higher than that of comparable countries in Sub-Saharan Africa. This reflects investors’ assessment of Ghana’s economic management and many have expressed fears that the ratio has gone beyond the point that is deemed prudent. The challenge for the country then is to find the resources to close the infrastructural gap without burdening future

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generations with unsustainable debts. One solution being explored is to bring in the private sector.

Figure 4: External Debt Stocks as a percentage of GNI, 1972-2012.

Another necessary ingredient is the institutional infrastructure – from regulatory structures to legal structures. Such institutions were seriously under-funded during the lean years and they are yet to play their needed role adequately due to under-capacity and corruption. The recent exposure of widespread corruption in the judiciary is particularly worrying. This makes doing business worrisome. All this has led to a situation in which the growth that has been occurring although higher than before the reforms is regarded as sub-optimal. Coupled with this is the inability to translate growth into the creation of jobs. Small businesses create most jobs but the poor business environment makes this difficult. Having the right kind of business environment then will make economic agents more responsive to price incentives, such as a currency depreciation. In principle a depreciation makes the economy more competitive which should generate more activity on the part of business in the export and import competing sector. They need a supportive environment to take advantage of such opportunities.

One big problem Ghana faces is that most of the industries created are still not capable of competing effectively with the best the world can offer. According to Lall (1992) ‘the low level of capabilities in Ghana has meant that rapid liberalisation, unaccompanied by supply-side measures to develop skills, capabilities and technical support, led to significant and costly de-industrialisation.’ Sad to say, this problem still exists currently. The dilemma facing the government in dealing with local manufacturing concerns can be summed up in this statement by the Minister of Finance in the 1994 budget: “Many domestic industries have high import and capital intensities and relatively low domestic value added. As a result anything short of the outright banning of competing imports will continue to be seen by them as providing inadequate protection” (Government of Ghana, 1994).

A study by Agbola (2008) highlights the challenges. The purpose of the study was to examine the adjustment of trade flows to exchange-rate stimuli of a small developing economy using data for Ghana between 1970 and 2002. The main finding was that devaluation worsens the trade balance in the long run. This suggests that Ghana’s economy was still rather weak to respond to market signals. He concludes by noting that this situation makes it difficult to use
only exchange rate reforms to manage external balance. This is in view of the considerable supply bottlenecks that still exist.

A challenge that has reared its head over the past few years is the discovery of oil in commercial quantities. Normally this should be a cause for joy but given the well-known natural resource curse many have advocated some caution.\textsuperscript{10} The biggest problem that countries experience with such natural resources is real exchange rate appreciation which would make the economy less competitive for other exports and goods. With a current production level of some 100,000 barrels a day and with peak production expected to be about 250,000 barrels, Ghana’s production is too low to significantly affect the real exchange rate through foreign exchange inflows. It has not happened so far and is not expected to happen. So with respect to the external sector oil should boost the current account without significantly strengthening the cedi. This should provide additional resources for badly needed investment in social and physical infrastructure. Measures are being put in place to ensure that these resources are not squandered as had happened in many resource-rich countries.\textsuperscript{11}

Ghana has become a middle income country and this should be a cause for celebration. The challenge though is that Ghana is no longer eligible for concessional inflows from the multilateral agencies. This means accessing loans on more stringent commercial terms which makes waste and inefficiency more costly. The 4\textsuperscript{th} Trade Policy Review by the WTO highlighted the fact that trade facilitation in Ghana is still a problem. Problems mentioned included slow clearance procedures and congestion at the ports. Such problems were identified by the Trade Policy document of 2006. Obviously progress is too slow.

5 Conclusion

The external sector is very crucial to a country such as Ghana that wants to develop rapidly. The main lesson that is evident from this chapter is that Ghana achieved comparatively better results with policies that are more outward oriented. Increasing globalization poses both challenges and opportunities. There is increasing competition for domestic producers, better deals for consumers and opportunities for exporters. Ghana will therefore have no choice but to position herself to get the maximum benefit from these trends.

References


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\textsuperscript{10}See for instance Sachs and Warner, 1997.

\textsuperscript{11}The Petroleum Revenue Management Act was passed by parliament in 2013 to ensure transparency in the use of the funds. Ghana has also joined the Extractive Industries Transparency Initiative among other actions.


