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Introduction: The Ghanaian Economy, Fragile Still

"I'll like to repeat without exaggeration that the Ghanaian economy is in a crisis," said Kwesi Botchwey, pointing to the high inflation, double-digit budget deficit and depreciation of the Ghanaian cedi.[1] Botchwey was the finance minister under the Provisional National Defence Council (PNDC) military government led by Jerry John Rawlings in the 1980s and under the first term of the National Democratic Congress (NDC) elected government in the 1990s. He is well known for being the lead negotiator with the International Monetary Fund (IMF) and World Bank on the first structural adjustment program, and he takes the title of Ghana's longest-serving finance minister. When the NDC returned to government in January 2009 after defeating the incumbent New Patriotic Party (NPP) in the December 2008 elections, Botchwey assumed a new role as a public intellectual. Laying out the country's options, Botchwey continued, "The country can decide that we will not go to the IMF for funds; we can decide instead of medium term drawing at lower cost from the IMF, we will borrow from international markets at greater cost and short tenure and with pretty much the same conditions."

On August 9, 2014, when the Mahama-led NDC government announced its decision to request an IMF bailout, the cedi had plummeted 36 percent since the beginning of the year, the fiscal deficit was set to reach 9.5 percent of GDP and public debt to GDP had exceeded 60 percent. The massive depreciation of the Ghanaian currency led international financial commentators to call the cedi one of the worst-performing currencies in Africa that year.[2] Inflation was into the

1 "Economic Crisis: 2014 Could Become Worse – Prof. Botchwey," June 4, 2014, peacefmonline, http://ghanaweb.com/GhanaHomePage/NewsArchive, accessed on September 1, 2015.
2 "Ghana's Cedi Zambia's Kwacha Worst African Currencies in 2014," December 31, 2014, Reuters, http://af.reuters.com/article/investingNews/idAFKBN0K90MS20141231, last accessed on September 10, 2015.

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double digits, and growth had declined dramatically. In the context of high inflation and currency depreciation, the purchasing power for much of the population fell precipitously. In April 2015, the government signed the IMF loan after implementing a series of "prior actions" to show its commitment to rectifying its problem of twin fiscal and trade deficits.

None of this is new. Ghana's economy experienced macroeconomic crises (of varying degrees) in 1992, 1996, 2000 and 2009. In fact, since the first structural adjustment loan in 1983, there have been only short periods when Ghanaian governments were not drawing on loans from the Bretton Woods institutions for balance of payments support. A country's balance of payments summarizes its economic transactions with the rest of the world. Ghana has a chronic problem of importing more than it exports and not having enough capital inflows (through foreign direct investment or portfolio investments) to make up the deficit, and of spending more than what can be covered by government revenues, leading to a build-up of domestic and external debt.

The latest macroeconomic crisis that began after the December 2012 elections led to a severe economic downturn. The rate of growth fell sharply, partly as a result of the exceptional growth spike after 2010 when the country began exporting oil, and it fell continuously, with growth in 2016 estimated at 3.6 percent, the lowest in over two decades. Growth was projected to rebound in 2017 due to the revival of the oil and gas industry, but the Ghanaian economy continued to be plagued by high fiscal deficits, especially after the December 2016 elections.

Recurrent macroeconomic crises in Ghana result from the "fragile" nature of the economy. The term "fragile" was first used in the opening line of the Seers-Ross report on the Gold Coast colony (now Ghana) in 1952 carried out by an economic mission from the British Colonial Office: "If we were forced to sum up the Gold Coast economy in one word, the word we would choose would be 'Fragile'."[3] By fragile, the authors of the report were referring to the general tendency of the economy towards instability caused by several factors. Almost all of the territory's exports (cocoa beans, gold, diamonds, manganese and timber) depended on the world market because they were not

[3] "Report on Financial and Physical Problems of Development in the Gold Coast," Dudley Seers and C.R. Ross, Government Printer, Accra, July 1952.

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consumed domestically. This made exports vulnerable to fluctuating global demand and volatile world market prices, which in turn led to instability in the amount of foreign exchange available in the country. The colonial territory was dependent on imports because little of what was imported could be produced domestically, people preferred imported brands, and there was great instability in domestic food production due to widespread rain-fed agriculture and an inefficient distribution system. The colonial government's budget was dependent on revenue derived from exports and imports. Together, these factors made the British colony susceptible to balance of payments problems, budget deficits and inflation. The Seers-Ross report concluded that the structure of the economy had to be changed by bringing domestic demand and domestic production more in line, by diversifying exports and by increasing agricultural production and productivity.

By the 2010s, these economic goals still had not been achieved. The structure of the Ghanaian economy was very similar to the one inherited at independence in 1957, which is referred to in this book as the colonial trading economy. This kind of economy is *shallow* in terms of what is produced domestically and the production capabilities of local firms; *narrow* in terms of the basket of exports and their complexity; and *thin* in terms of linkages within the economy among domestic producers of intermediate goods and services. In other words, there had been limited economic transformation. Economic transformation involves several separate but interconnected processes, including export diversification, increasing agricultural productivity, industrial deepening through creating backward and forward linkages between industries in the economy, industrial upgrading by moving into the production of more complex technological activities within national industries and global production networks, and building the technological capabilities of local firms and farms.[4]

International and domestic observers are often puzzled about why Ghana's economy has not performed better, especially given the country's strong democratic record in recent decades compared to most African countries. This book aims to unpack that puzzle. It is a story of the economic and political challenges to economic transformation in

[4] The literature on economic development uses the terms structural change, structural transformation and economic transformation interchangeably to refer to the same set of processes.

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Ghana. These challenges have their origins in the economy inherited at independence and the political struggles for power that emerged during decolonization, which created path dependencies that have proven very difficult to break.

Moving through the decades of the postindependence period up to the present, the book explains why successive governments have not been able to transform the colonial trading economy. The argument emphasizes the necessity of industrial policy to catalyze economic transformation and concludes that Ghanaian governments have not been very successful in implementing industrial policies. Industrial policy is a broad term that refers to any government initiative targeted to support the development of specific industries and even firms. Industrial policy has to be targeted because industries face different institutional challenges and have specific needs related to the type of production and export markets.[5]

There is renewed interest within academic circles as well as international organizations and African governments regarding the need for industrial policy. In the early 2010s, arguments that African countries required economic transformation in order to generate self-sustaining growth and rising incomes gained attention in international and national fora.[6] The renewed discussion on economic transformation reopened the debate on the need for state intervention and industrial policy, what kinds of politics were necessary to support industrial policy and whether this kind of politics could be found or nurtured in African countries.[7]

This book contributes to that debate by looking at the particular case of Ghana, which differs significantly from countries such as Ethiopia and Rwanda that have so far dominated the discussion on industrial

[5] This book does not provide a review of the literature on economic transformation and industrial policy, nor of the debates regarding industrial policy, as these topics are covered elsewhere. See for example chapter 2 in Whitfield et al. (2015), and chapter 1 in Oqubay (2015).

[6] See for example, ECA (2011); Dinh et al. (2013) at the World Bank; and Amoako (2011), President of the African Center for Economic Transformation in Accra, Ghana.

[7] See for example, the collective volume *Good Growth and Governance in Africa* edited by Noman and colleagues (2012); *The Industrial Policy Revolution II: Africa in the Twenty-First Century* edited by Stiglitz and colleagues (2013); *Business, Politics and the State in Africa* by Kelsall and colleagues (2013); and *The Politics of African Industrial Policy* by Whitfield and colleagues (2015).

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policy in Africa.[8] All industrial policies are difficult to implement because they are inherently political, but some country contexts are more difficult than others due to the distribution of power in society. Ghana's context of competitive clientelism with weak domestic capitalists is one of the most difficult.

Competitive clientelism emerges in developing countries where the distribution of power in society is highly dispersed, and as a result there is a large group of fragmented political elites who enter shifting alliances to form a coalition strong enough to govern the country and the state apparatus. The highly fragmented nature of political elites means that a ruling coalition faces strong political opposition and also that the ruling political elites are fragmented and in constant competition with each other for political positions and state resources to gain and maintain those positions.[9] In addition, the political leaders of competitive clientelist coalitions enjoy strong political support among highly mobilized and organized groups, but these groups in turn constrain the resource allocation decisions of the leadership through their distributional demands or resistance to changes in the existing allocation of resources.

Competitive clientelism is actually the most common form of clientelism in developing countries because informal power in society is highly dispersed in most developing countries.[10] It is called *competitive* clientelism, because political leaders compete for lower-level supporters in a relatively open system of bargaining and coalition formation. Ruling political leaders can attempt to "buy in" groups and supporters of the opposition, and discontented leaders of highly mobilized groups and political factions within the ruling coalition can leave and join the opposition. But the specific nature of competitive clientelism can, and does, vary across developing countries as a result of differences in the intensity and the exact nature in which informal power is dispersed across groups in a particular society. This book

[8] See Oqubay (2015) on Ethiopia, and Booth and Golooba-Mutebi (2012) and Behuria (2016) on Rwanda.

[9] The term ruling political elites refers to the group of people who wield power as a result of their position in government, where they occupy offices in which authoritative decisions are made. Ruling coalition refers to the ruling elites, as well as the groups and individuals behind the rise of the ruling elites and/or those groups or individuals that keep the ruling elites in government by organizing political support for them.

[10] For a discussion on why this is the case, see Migdal (1988) and Khan (2010).

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describes the particular form of competitive clientelism in Ghana as a result of historical developments and their legacies.

Through multiparty elections, the political configuration of competitive clientelism can result in political stability because voting is a test of the relative organizational strength of different parties, which are political coalitions. A successful change in government through elections, however, requires that the different political coalitions accept that the election outcomes are an accurate representation of their factional strength and thus that there was not significant electoral fraud. Ghana's political stability and successful changes in the ruling party through elections under the Fourth Republic are due to relatively free and fair elections, an Electoral Commission that is seen by political elites as a neutral referee, and an Inter-Party Advisory Committee that brings together political elites from the main parties to negotiate changes deemed required to maintain free and fair elections and thus an accurate representation of their relative strengths.[11]

While competitive clientelism can lead to political stability, as shown in the case of Ghana, it is not good for industrial policy. It makes it difficult for ruling political elites to pursue and implement industrial policies because there is a high degree of contestation among political elites and their elite factions combined with large distributional demands from lower-level groups and supporters within the ruling coalition. The more competitive elections are, the higher the contestation and distributional demands. Countries that have had some success with industrial policy despite having competitive clientelism, such as Thailand, are ones in which a relatively large group of domestic capitalists with investments in productive sectors already existed and were able to wield some political influence.[12]

In contrast, competitive clientelism in Ghana has occurred alongside weak domestic capitalists. The term weak domestic capitalists is used as shorthand to denote that individual domestic capitalists in productive sectors – that is, agrarian and industrial capitalists (and not merchant capitalists involved only in trading) – are weak. They

[11] For commentary on the democratic nature of the December 2016 elections and the role of the Electoral Commission and Inter-Party Advisory Committee, see Cheeseman, Lynch and Willis (2017). Elections are discussed in Chapter 3 of this book.

[12] For a discussion of competitive clientelism in Thailand, see Doner and Ramsay (1998).

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are weak in the sense that they have low productive and organizational capabilities and thus cannot produce much at international levels of efficiency and meet international quality standards. They are also weak in the sense of having limited political influence over policy content and implementation.

This book argues that the combination of competitive clientelism with weak domestic capitalists produced a structure of incentives that shaped the political survival strategies of ruling political elites and in turn their policy choices. In order to keep their ruling coalition together, political leaders needed to meet the distributional demands of elite factions and lower-level supporters within the coalition. At the same time, domestic capitalists had only limited political influence on how state resources were allocated and invested, and their low level of capabilities provided them with little motivation to make risky investments in productive sectors with the small resources they were able to capture without broader state support to make sure those investments became profitable. This distribution of power resulted in two key features that have characterized the policy choices of nearly every government since the country's independence.

The first key feature is that ruling political elites, calculating the short-term need for political survival against rival political elites, chose government expenditures that consisted mainly of distributive spending that could reward patron-client support networks and provide individual and collective benefits for voters. As a result, resources were consumed but were not reproduced in the sense of productive investments that would lead to growth and thus generate more resources through taxes, jobs and incomes. The short time horizon of ruling elites in pursuit of political survival also led them to avoid policies or programs that involved significant changes in the allocation of existing resources, especially if they involved short-term negative effects on a large portion of the population. Since most industrial policies involve some change in the immediate distribution of benefits, political elites did not pursue and implement many of the institutional changes required to increase production and productivity in agriculture and manufacturing.

Second, when ruling political elites in Ghana did pursue productivity-enhancing expenditures, they chose state-led investments in agriculture and manufacturing rather than industrial policies that incentivized private investments and supported the development of productive

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capabilities among private domestic firms. This is because state-led investments allowed the ruling party to take credit for the investments at election time, in an attempt to sway voters, and to control the generation and distribution of rents, which they channeled through patron-client networks to reward supporters and keep them in the coalition. The motivation of ruling elites was to try to keep control over economic opportunities and wealth accumulation due to the competitive nature of rival coalitions, but *paradoxically* the rival sources of power and elite fragmentation within ruling coalitions made it difficult for political leaders to implement state-led industrial policies. As a result, state-led industrial policies were poorly implemented. Both kinds of government expenditures that were popular with Ghanaian governments – distributive spending and state-led industrial policies – had limited impacts on developing the productive sectors of the economy and thus economic transformation.

Ghana is not unique in having weak domestic capitalists. On the African continent, domestic capitalists have been small and relatively weak in terms of their productive capabilities and political influence for historical reasons, except most notably in Mauritius and South Africa.[13] However, due to differing historical developments and legacies that affected political elite formation and the mobilization and organization of social groups, not all African countries are characterized by competitive clientelism. In African countries where the distribution of power at independence was not highly dispersed, or in countries where internal or external shocks such as civil wars changed the distribution of power, we see different political configurations.[14] This variation in political configurations largely accounts for the differences in the extent to which African governments actively pursue and successfully implement industrial policies. In countries where the distribution of power in society is less dispersed and where political elites are less fragmented, governments have more success in

[13] For a summary, see Whitfield et al. (2015: 90–96). For a seminal work on this topic in the case of Senegal, see Boone (1992). On South Africa, see Handley (2008), and on Mauritius, see Brautigam (2009).

[14] The other broad types of political configurations in developing countries, based on the distribution of power in society, are strong dominant party, weak dominant party, and vulnerable authoritarian. For a discussion of these types and their implications for industrial policymaking and implementation, see Khan (2010), Whitfield et al. (2015), and Kelsall et al. (2013).

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implementing industrial policies and even state-led investment projects, as in Ethiopia.

Nevertheless, there are a significant number of African countries that are characterized by competitive clientelism, and a number of countries that are increasingly heading towards competitive clientelism as elite factions break away from dominant parties, such as in Uganda. Therefore, Ghana's story is one that resonates with the experiences of many African countries and can illuminate broader issues and challenges to economic transformation on the subcontinent. Furthermore, the diversity across African countries in term of variations in the political configurations and the strength of domestic capitalists highlights the importance of taking into account the political dimension of industrial policy. "What works" cannot be generalized, but rather industrial policy advice has to be tailored for each country, taking into account the distribution of power and its implications.

Elaborating the Challenges to Economic Transformation

The Gold Coast and then independent Ghana experienced an average annual growth rate of 4.1 percent between 1950 and 1960, which dropped to 2.2 percent between 1960 and 1970 as the country hit its first macroeconomic crisis and its first coup d'état in 1966. Between 1970 and 1981, the years of political turmoil, the economy actually contracted, with a negative average annual growth rate of –0.3 percent as government after government failed to implement economic reforms to reverse the trajectory.[15] The economic decline was not reversed until 1983, when the government began economic reforms with financing from the World Bank and IMF. On the back of the structural adjustment lending and policy prescriptions, Ghana experienced sustained but modest growth in the 1990s and 2000s, achieving lower-middle-income status in 2010.[16] However, the growth turnaround was not accompanied by significant changes in the structure of the economy.

[15] These growth statistics are from Rimmer (1992: 208).

[16] When the Ghana Statistical Service changed the way that it calculated GDP in 2010 through a revision of the base year from 1993 to 2006, per capita income was revised upward to $1,289, qualifying it as a lower-middle-income country. The base year influences estimates of the size of the economy as it indicates which economic activities are captured and their relative importance. The revision in the national accounts estimates was based on incorporating a considerable amount of data from new surveys that allowed for wider coverage of economic activities

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The structural adjustment reforms halted the country's economic decline, but they also had the effect of reviving the colonial trading economy structure, after the failed attempts in the 1960s and 1970s to catalyze economic transformation through state-led industrial policies. This is because the reforms liberalized imports while only directly supporting the revival of the traditional export industries: cocoa and gold. The structural adjustment loans helped to rebuild infrastructure, social services and pay for imports, but they had little impact on developing other export sectors, increasing agricultural productivity in food crops or helping locally owned manufacturing firms to compete in the domestic market in the context of rapid trade liberalization. As a result, agriculture and manufacturing growth rates tailed off in the 1990s, and the service sector became the largest sector of the economy from the mid-2000s. Economic growth became increasingly consumption-driven and led by the service sector, which includes public services, services in the informal sector and services linked to oil, gas and mining. By the end of the 1990s, the urban population surpassed the rural population and continued to grow. This urbanization led to "consumption cities," where services and other nontradable activities were the main employment creators and sources of nonagricultural income (Kolavalli et al. 2012). Thus, Ghana achieved urbanization without industrialization.

Ghanaian governments still depended on gold and cocoa exports, and then oil, for generating foreign exchange and for a significant amount of government revenue. Production capabilities were limited due to generally low productivity in agriculture and stagnating manufacturing, so little of what citizens consumed was produced in the country. The absence of a takeoff in other productive sectors, especially ones oriented to exporting, left the economy in a vulnerable position: a limited base for generating export revenue, dependence on imports for most consumer goods in addition to intermediate and capital goods, and little formal employment generation in the private sector, which meant heavy reliance on the public sector to create jobs.

In explaining the puzzle of limited economic transformation in Ghana, this book has two objectives. The first is to demonstrate that

(Jerven and Duncan 2012). The previous way of estimating the national accounts reflected the structure of the Ghanaian economy in 1993 and thus overemphasized the decline in previous sources of growth such as state-owned enterprises.

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