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CHAPTER II

Evolution of the restrictive system

1. Introduction[1]

The early 1960's marked a major change in the direction of Ghanaian external economic policy. A relatively free system of international trade and payments was replaced by a restrictive foreign-exchange regime involving licencing and exchange control. The consequences for the structure and performance of the Ghanaian economy were profound. In this chapter we set the stage by examining the evolution of the system.

The history of the restrictive exchange regime is one of hasty introduction, difficult implementation, frequent change, organized corruption, serious shortages, and finally an attempted liberalization. To provide an overview of the history we begin in section 2 by characterizing the system as a series of phases (see also Appendix F-2). Given the outline provided by the phases, we analyze in subsequent sections the various instruments used to influence the foreign-exchange market, reporting several indicators of restrictiveness. There has been a great variety of instruments available and used; some consciously adopted to achieve foreign-exchange objectives, others only inadvertently brought to bear on the situation. First, there are those such as taxes and subsidies on trade which introduce an explicit price differential and leave quantities to adjust. These are treated in section 3. Second, some instruments operate by affecting the financing available for foreign transactions. These we deal with in section 4. Third, there are instruments such as licences which restrict quantities and leave the corresponding domestic prices to adjust. We discuss these in section 5. Finally, there are instruments such as fiscal and monetary policies which affect the levels of aggregate demand and overall domestic prices. We consider these instruments in section 6, not so much because they were heavily relied upon but more because they were frequently

1. This chapter draws heavily on both the documentary record and interviews with Ghanaian officials past and present. While exonerating the latter from any responsibility for what is contained here, I wish to acknowledge their generous assistance. In particular, I would like to single out for special thanks S.K. Botchway, R.K.O. Djang, H.P. Nelson, J. Phillips, and Dr. J. Ofori-Atta. Valuable research assistance for this chapter was provided at various stages by M. Behkish, E. Hall, and S.M. Ntim.

forgotten in the proliferation of approaches to the foreign exchange problem.[2]

It is important to keep in mind that all instruments will affect the exchange regime's restrictiveness. Hence in the following delineation of phases based on varying degrees of restrictiveness we have attempted to take an overview of the entire set, even though most of our quantitative indicators refer only to taxes on trade.

2. Delineation of phases

The Ghanaian experience with a restrictive foreign-exchange regime has been one of both sudden and gradual changes, making a precise delineation of phases subject to a necessarily arbitrary selection of dates.[3] With this qualification in mind, the following sequence represents a brief survey of the restrictive regime. An overview of the phases set against several key economic variables is contained in Chart II-1.

(a) Liberal regime, 1950–1961 (Phase V)

Ghana, as a member of the sterling area, was subject to the general prescription of currency requirements of the area as a whole. Payments to and from other countries of the area were relatively free while payments to and from countries outside the area were subject to the sterling restrictions. Within this framework Ghana experienced a fairly liberal regime.

The most interesting feature of this period was the rapid buildup of foreign exchange reserves in the boom years of the Korean war, followed by a gradual drawing down of the large reserve accumulation. After independence in 1957 the drawing down of reserves accelerated, still largely within a permissive liberal system (see Table A-3b). The acceleration of reserve loss continued, to the point that in 1961 the payments pressure had become untenable and controls were rapidly imposed.

(b) Imposition of controls, 1961–1963 (Phase I)

A variety of instruments were brought to bear on the rapidly growing balance-of-payments deficit. Initially exchange control was extended to in-

2. We do not wish to overdraw the distinctions among the various instruments. For example, stiff new indirect taxes on trade will dampen aggregate demand while implementation of fiscal policy may require changes in taxes on trade. Our distinctions are made largely as a means of organizing the discussion.
3. The phase numbers refer to those set out below, Appendix F-2. Detailed description will be found in J.N. Bhagwati and A.O. Krueger, *Exchange Control, Liberalization, and Development: Experience and Analysis,* forthcoming.

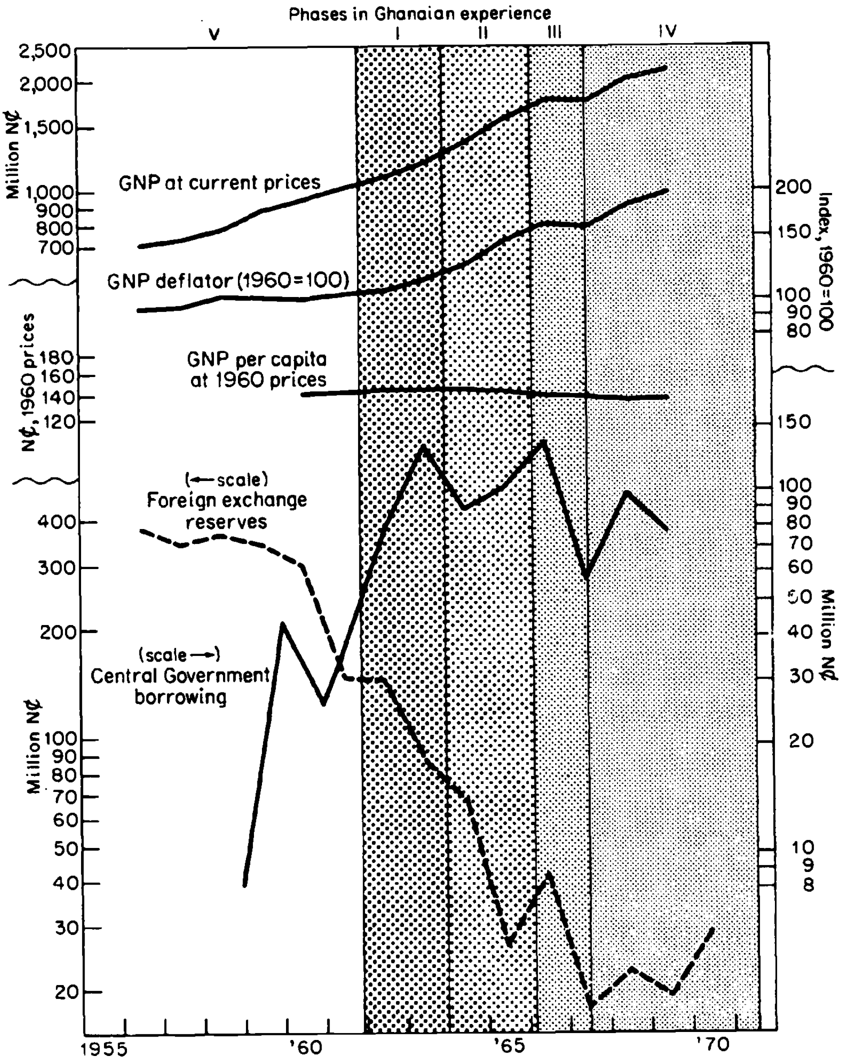

Chart II-1

clude the sterling area, several bilateral trade and payments pacts were launched, and an attempt was made to employ conventional methods to suppress aggregate demand in general and demand for imports in particular. On current account any effect these might have had was swamped by speculative demand for imports in anticipation of licencing. The apparently inevitable application of import licencing came on December 1, 1961.

During 1962 the new restrictive system was sorted out, and was reasonably settled by year end. It continued with a few minor changes during most of 1963. The level and distribution of exchange allocations were based on estimated foreign-exchange availability and perceived national needs (e.g., import-substitution, industrialization, and diversification of trade toward East Bloc countries).

(c) Breakdown of system, 1964–1966 (Phase II)

Beginning in late 1963 the system experienced a variety of changes, the most notable of which was the introduction of substantial corruption in the issue of import licences. Changes in regulations were frequent in a frantic attempt to patch up a system that had one big hole in it: the corrupt and erratic issue of import licences. This culminated in a splurge of imports and massive assumption of short-term debt for 1965. The country was left with a foreign debt amounting to about one-half of Gross Domestic Product (GDP), and no substantial new lines of credit at the time of the *coup d'état* overthrowing President Nkrumah in early 1966.

(d) Austerity and devaluation, 1966–1967 (Phase III)

The military-civilian National Liberation Council (NLC) government that replaced Nkrumah chose to follow a "stabilization" program in which *de jure* the system changed little, but *de facto* involved a resumption of the type of controls employed in 1962 and 1963 (prior to the massive corruption of 1964–1966) combined with the imposition of a substantial expenditure reduction. Temporary relief of payments pressure was also achieved by a major rescheduling of short-term external debt.

It soon became evident to both the government and to outside official agencies supporting its efforts that these policies were not enough to contain the payments pressure. In July 1967 Ghana resorted to major devaluation.

(e) Import liberalization, 1967–1970 (Phase IV)

The devaluation was a turning point in the direction of gradual liberalization of the trade and payments regime. Beginning with a few moves at the time of devaluation and continuing for over three years, both the NLC government and the government of Prime Minister Busia (elected in 1969) gradually reduced the specific import-licence list to the point that by the end of 1970 about 60 per cent of all imports had been removed from the specific licence list. The task of dismantling the complex import-control syster proved difficult, and because many controls still remained in place the ex pected benefits were slow to emerge. Further, a number of strategic error: were made which in the end proved fatal to the import liberalization. Taxes on freed imports were relatively low. Aggregate demand pressure was not contained. And a huge windfall of cocoa export earnings was not treated as such.

(f) Collapse of import liberalization, 1971–1972 (return to Phase I)

When cocoa export revenues resumed more normal levels in 1971 it became evident that external payments were at an unsustainable level. The open deficit would somehow have to be closed. Despite this, imports were further liberalized in mid-1971, and no substantial moves to dampen the demand for imports were taken. As the payments pressure accelerated during late 1971 the need for a quick solution became pressing. Still fully committed to the import liberalization approach they had adopted, only two options appeared feasible to the government: debt relief and devaluation. Very little debt relief was obtained, and the government chose not to repudiate any of the debts. Instead, it settled on a huge devaluation of nearly 80 per cent. The jolt of the sudden reduction in real income implied by the devaluation was too much for the fragile political situation. The military stepped in, with evident popular support, to end both the experiment in democratic government and the import liberalization.

The remainder of this chapter is devoted to a detailed discussion of Phases I, II and III. Phase IV and the return to Phase I are taken up in Chapter V.

3. *Taxes on foreign trade*

By far the most important and extensively used instruments have been taxes on trade. Initially employed primarily as a source of government revenue, trade taxes came subsequently to be used as a balance-of-payments instrument. Because they have been so significant in the Ghanaian experience they merit extended consideration. We begin by reviewing the mechanisms whereby trade taxes affect the foreign-exchange market, and then examine the magnitudes of taxes employed.

Underlying the generation and use of foreign exchange are the domestic markets in which exporters are paid and importers pay in local currency for the goods and services that are sold on or purchased from international markets. If there are taxes on these transactions the rates at which domestic offers and demands of local currency (new cedis or "N₵") for dollars rise will differ from the rates at which national offers and demands are made. On the export side a tax means that exporters receive fewer new cedis per dollar than the nation does. And on the import side tariffs mean that the importers pay more new cedis per dollar of imports than the nation does. The rates of tax indicate the degree of divergence or "distortion"[4] facing the sellers of exports and purchasers of imports *vis-à-vis* the international market in one way: as rates with respect to the international prices of the goods. These rates can be converted into rates in terms of the foreign-exchange market and subtracted from (export tax) or added to (import tariff) the official exchange rate to yield effective exchange rates: the new cedis earned by an exporter per dollar's worth of exports and the new cedis paid by importers per dollar's worth of imports.

Algebraically, for each of the export and import sides a rate of new cedis per dollar facing the exporter or importer can be expressed in the following manner. For the exporter the new cedi receipts are less than in national export values by proportion of the *ad valorem* export tax rate (t_x). Converting this at the official new cedis per dollar exchange rate (r) yields the effective exchange rate on exports (EER_x):

$$\text{EER}_x = 1 - t_x)r. \qquad \text{(II.1)}$$

Similarly, on the import side where t_m is the *ad valorem* tariff rate on imports, the effective exchange rate on imports (EER_m) is:

$$\text{EER}_m = (1 + t_m)r. \qquad \text{(II.2)}$$

For a number of reasons the effective exchange rate may change without a change in the official exchange rate. Anything that alters the new cedis that purchasers of imports pay for a dollar's worth of imports or exporters receive for a dollar's worth of exports will alter the relevant effective exchange rate. Changes in the rate of export tax or import tariff will clearly change the effective exchange rate. So also will the introduction of some new levy or transfer that is a function of exporting or importing.

Examples of this type of change include the introduction of a compulsory 180-day deferred payment or credit for imports[5] and a 1 percent import licence fee, which add to the degree of distortion and hence increase the effective exchange rate on imports. Further, a change in the *ad valorem* equivalent rate of tax or tariff may come about even in the absence of explicit action. Such is the case of cocoa where the divergence between

4. "Distortion" in this sense carries no normative connotation. Rather, it is a concept used in theory to refer to the existence of some change in a relationship. In this case the one to one relationship between domestic and international prices of a tradeable is altered or "distorted" by a trade tax.
5. Payment in foreign exchange to suppliers of imports is deferred 180 days from the time of local currency payment by the importer.

producer receipts and national export receipts is a residual that depends on the arbitrarily fixed producer price[6] and the constantly moving export price. On the import side most tariffs are scheduled at *ad valorem* rates, but exemptions are numerous and arbitrary, yielding constant changes in the average effective import exchange rates even at the most disaggregated level. Putting all these together, we have calculated the rates of trade taxes facing importers and exporters over the period since 1955, and in turn the corresponding effective exchange rates.

(a) Import effective exchange rate

The data for the import side are contained in Table II-1. Note first the gradual proliferation of instruments.[7] For many years only the tariff was used, but in the 1960's the authorities resorted first to a purchase tax,[8] followed by a sales tax,[9] a 180-day compulsory credit scheme,[10] the small import licence fee,[11] and finally surcharges.[12] The overall sum of these instruments traced out a fairly constant path of the effective import-exchange rate from 1955 through 1960, an accelerated rise through 1965, and a decline

6. The producer price at the buying stations scattered throughout the country is fixed without direct reference to the world price and is kept constant for periods ranging up to several years.
7. Omitted from these calculations are the effects of various instruments used to control the financing of foreign trade set out in section 4 below. Their omission is due to their small and generally non-quantifiable effects.
8. Instituted July 1961 and applied almost entirely to imported manufactured goods. Abolished January 1965 on all but motor vehicles in conjunction with increased tariff rates.
9. Applied to both imported and domestic goods, but dampening demand for imports. It is administered as a manufacturer's sales tax. Act dated 21 January, 1965.
10. Instituted March 1965. M.J. Sharpston in his forthcoming study "The Costs of Trade and Tariff Policy: The Case of Ghana," Cambridge University Dept. of Applied Economics, *Occasional Paper*, Chap. 3, develops estimates of the import-cost inflation due to this scheme. His estimates range from 6 percent to 20 percent of the invoice value, depending on the nature of the goods and size of the importer. This is made up of the allowed 6 percent per annum interest cost plus higher prices of goods due to export credit cover, loss of cash discount, and the cost of using confirming houses. As a conservative estimate of the average effect we have assumed an 8 percent of c.i.f. value cost inflation due to this scheme. This is made up of 5 percent higher price charged by suppliers and a 3 percent allowance for interest (at 6 percent per annum). Aid-financed imports and bilateral trade pact imports are not subject to this compulsory credit. However, because of the impossibility of separating out such imports, in our calculations we applied the average minimum inflation of import cost to total imports.
11. Applicable in 1966, 1967 and 1968 only.
12. Begun February 1969; National Liberation Council, *Decree 325*, 11 February, 1969.

TABLE II-1

Price distortions facing total imports and corresponding effective exchange rates, 1955 through 1969 (percentages of c.i.f. value, and new cedis per dollar)

Year	Tariffs	Purchase tax	Sales tax	Surcharge	180-day credit	Import licence fee	Total rate	Absolute change from 1955	Effective exchange rate (N₵/$1)	Percent change in EER from 1955
1955	17.07	–	–	–	–	–	17.07	–	0.8362	–
1956	17.14	–	–	–	–	–	17.14	0.07	0.8367	0.06
1957	17.46	–	–	–	–	–	17.46	0.39	0.8390	0.33
1958	17.61	–	–	–	–	–	17.61	0.54	0.8401	0.47
1959	15.38	–	–	–	–	–	15.38	−1.69	0.8241	−1.45
1960	17.03	–	–	–	–	–	17.03	−0.04	0.8359	−0.04
1961	21.45	0.78	–	–	–	–	22.23	5.16	0.8730	4.40
1962	25.92	1.77	–	–	–	–	27.69	10.62	0.9120	9.06
1963	26.78	1.86	–	–	–	–	28.64	11.57	0.9189	9.89
1964	27.90	2.26	–	–	–	–	30.16	13.09	0.9297	11.18
1965	26.47	0.7	10.89	–	9.87	–	47.93	30.86	1.0566	26.36
1966	30.83	1.11	12.33	–	10.21	1.00	55.48	38.41	1.1105	32.80
1967 A	28.98	1.27	10.57	–	10.04	1.00	51.86	34.79	1.0847	29.71
1967 B	25.89	0.91	9.67	–	9.82	1.00	47.29	30.22	1.5029	79.72
1968	20.10	0.79	5.38	–	9.31	1.00	36.58	19.51	1.3937	66.67
1969	17.07	0.83	4.59	0.82	9.15	–	32.46	15.39	1.3516	61.64
1970	17.02	0.91	7.82	2.56	9.42	–	37.73	20.66	1.4054	68.07
1971	18.57	1.39	7.41	5.71	9.65	–	42.73	25.66	1.4564	74.17

Notes and Sources: See next page.

Notes to Table II-1

Notes:
1. See Appendix B for details at the 1-digit SITC level.
2. Entry of [–] indicates instrument not operative for year.
3. 1967A is January through June; 1967B is July through December. Devaluation July 8, 1967.
4. Exchange rate to July 8, 1967 was N₵ 0.714286/$1, and after was N₵ 1.020408/$1.
5. The average effective exchange rate for 1967 (weighted by dollar value of imports) is, 1.2717 $1/N₵.
6. 1971, provisional.

Sources:
1. Import tariff rates calculated from imports and collections data found in CBS, *Quarterly Digest of Statistics*, 1956–1969.
2. Collections data for purchase tax, sales tax, surcharge, and 1970 and 1971 tariffs supplied by Ghana Customs and Excise. Special thanks for extracting these data are due to Mr. Quaye of the Statistics Section.
3. The 180-day credit scheme effect calculated on assumption that it increased the c.i.f. price by 5 percent (and hence included in the base for the duty and other collections) plus the allowable 6 percent per annum (*i.e.*, 3 percent of value) interest cost.

from 1965 through 1969: which, however, was more than offset by the 1967 official devaluation. These direct price divergences accounted for a 22 percent devaluation of the import effective exchange rate 1955 through 1971. Taking into account the 43 percent official devaluation in 1967, the effective price of foreign exchange facing importers increased by 75 percent over the period 1955 to 1971.[13]

(b) Export effective exchange rate

Turning to the export side, trade taxes have been levied in various forms on cocoa, wood and timber, and diamonds.[14] For cocoa, we have included the tax implicit in the Cocoa Marketing Board (CMB) surplus of sales value over purchase and operating costs, while for wood and diamonds we have used simply the government tax receipts. The results (Table II-2) clearly indicate that the major export tax is on cocoa, while wood and diamonds have been subject to very low rates. This, of course, is due to the fact that Ghana has employed the cocoa export tax as a device to obtain monopoly

13. These data are in nominal terms only. We adjust for the price level in Table II-8 below. Note that the effective exchange rate is the product of the import taxes and the exchange rate.
14. Other minerals (bauxite and manganese) were subject to an export tax in earlier years, but in 1952 this was changed to an internal mineral duty, and revised again in 1962. As it now stands the minerals tax is implicitly a royalty payment on a sliding scale, depending on operating costs.

TABLE II-2

Price distortions facing taxed exports and total exports, and corresponding effective exchange rates, 1955 through 1969 (percentages of f.o.b. value and new cedis per dollar)

Year	Cocoa		Wood and timber		Diamonds		Total exports		Total excl. cocoa	
	Tax rate	EER_x	Tax rate	EER_x	Tax rate	EER_x	Tax rate	EER_x	Tax rate	EER_x
1955	44.74	0.3946	1.67	0.7024	4.89	0.6794	31.26	0.4910	1.4	0.7043
1956	13.22	0.6198	1.99	0.7001	4.93	0.6791	8.55	0.6532	1.74	0.7019
1957	33.79	0.4728	1.72	0.7020	5.04	0.6783	19.61	0.5742	1.58	0.7030
1958	49.55	0.3603	1.93	0.7005	5.20	0.6771	30.86	0.4939	1.65	0.7026
1959	37.07	0.4495	2.26	0.6981	5.04	0.6783	24.00	0.5429	1.76	0.7017
1960	19.68	0.5737	2.94	0.6933	3.87	0.6866	12.36	0.6260	1.90	0.7007
1961	39.70	0.4307	2.88	0.6937	4.34	0.6833	25.68	0.5309	1.85	0.7011
1962	4.04	0.6854	2.95	0.6932	2.69	0.6951	3.07	0.6924	1.45	0.7040
1963	22.73	0.5519	2.98	0.6930	2.98	0.6930	15.80	0.6014	1.52	0.7034
1964	–3.02	0.7358	2.42	0.6970	1.83	0.7012	–1.46	0.7247	1.41	0.7042
1965	54.25	0.3267	3.10	0.6921	0.14	0.7133	51.26	0.3481	1.13	0.7062
1966	40.59	0.4243	3.39	0.6901	0.02	0.7142	35.78	0.4587	1.08	0.7066
1967 A	27.95	0.5146	3.15	0.6918			17.94	0.5861	0.87	0.7081
1967 B		0.7352		0.9883				0.8374		1.012
1968	40.66	0.6055	2.22	0.9977			25.93	0.7558	0.63	1.014
1969	46.87	0.5422	1.92	1.008			30.95	0.7046	0.55	1.015

Note: Total includes taxes on kola nuts (1955 through 1969) and pepper (1968 only).

Sources: 1. For cocoa, our own calculations are employed; using CMB *Annual Reports,* we converted from crop year to calendar year, estimated CMB costs (included in producer costs), and estimated local sales (included in base of exports tax). Details of these calculations are available from the author, on request.

2. All other tax collections and export values from CBS, *Quarterly Digest of Statistics,* 1956 through 1969.

profits from cocoa, while for the other exports such a strategy is not possible because of Ghana's insignificant shares of the world market.

The implicit cocoa export tax exhibits considerable instability, due largely to the policy of fixed producer prices in the face of variable supply and stable cocoa export earnings. Consequently, the changes in implicit tax revenue that emerge are in large part due to the changes in the volume produced and shipped by Ghana.[15] The bumper crop of 1964 is the clearest example of a low tax due to high volume, while in the later 1960's the lower volume meant an increased tax rate. For wood and timber the tax rate rose up to the time of the 1967 devaluation and declined thereafter, due in part to the specific nature of the tax, but mostly to reduced levies that accompanied devaluation. The tax on diamond exports before 1962 was on all diamond exports, but from that date applied only to diamonds won (dug) by African diggers and not to commercial mines which paid instead the internal mineral duty.[16] The officially recorded output of African diggers virtually disappeared in the 1960's, and as a consequence the export tax rate on diamonds on the whole declined to near zero. The tax was eventually abandoned at the time of the devaluation.

Looking at the export and import sides together we see a widening gap between the effective exchange rates facing average importers and average (total) exporters. The upward trend in the import rate since 1960, due to both higher import taxes and the devaluation (which was only slightly offset by lower import taxes), together with the relative constancy of the total export tax rate, meant that the excess of the effective exchange rate on imports over that on total exports rose by about 0.30 N₵ per dollar from 1955 to 1969. If, however, we exclude cocoa from our export calculations, it is clear that the major widening of the gap between the import and export rates took place between 1960 and 1965, with a slight reduction subsequently. Thus in broad terms the discrimination in favor of import-competing production and relatively against non-cocoa export production developed during the period in which quantitative restrictions emerged.

15. On the stability of earnings see J.C. Leith, "Export Concentration and Instability: The Case of Ghana," *Economic Bulletin of Ghana*, Second Series, Vol. 1, No. 1, 1971. The average annual deviation of earnings from trend for cocoa was about 4.4 percent in the period 1957 through 1965. A good crop, for example, leaves total cocoa earnings virtually unchanged as the price falls. Yet producers' incomes rise due to the fixed price they receive, while the tax (which is the residual between producer and total receipts) falls.

16. See note 14 concerning the internal mineral duty.

4. Financing of foreign trade

A further approach used by the Ghanaian government to influence the foreign exchange market consisted of various devices to affect the financing of foreign trade. These differ from taxes on trade in that no measurable explicit commodity price differential is introduced. They are, however, fundamentally similar in that they work through the price system in the commodity market, and do not involve a suspension of the commodity market as licences and controls do.[17]

Three instruments of this type were used: (1) regulation of payment terms, (2) regulation of the credit available for foreign trade, and (3) prior deposits on imports. The first was begun by Exchange Control in early 1962, while the other two were not introduced until April 1964, when the Bank of Ghana assumed an expanded role in the regulation of credit.

(a) Regulation of payment terms

With the institution of exchange control and licencing in 1961 it very quickly became evident to the authorities that improved payment terms on the part of the Ghanaian importer could be used as a method of offsetting suppliers' concern over the new restrictions. This had the unwanted effect of speeding up foreign-exchange payments. Exchange control regulations dealing with payment for imports were therefore issued (February 1962) and subsequently revised from time to time. These regulations required Authorized Dealers in foreign exchange (i.e., the commercial banks) to ensure that payment terms conformed with those specified in the import licence and to obtain a number of supporting documents: manufacturers' and suppliers' invoices, bill of lading, and customs entry form. In general, payment for imports could be authorized only against documents (i.e., goods already shipped) or evidence of importation. Remittances prior to dispatch of goods could not be made without specific prior approval, and were seldom allowed.[18] Regulations further specified details and/or limits of commission payments, freight charges, insurance on goods, interest on acceptance bills, normal bank charges, and rebates on acceptance bills paid before maturity.[19]

17. The compulsory 180-day credit scheme perhaps falls within this definition, but because it is translated, virtually automatically, into an implicit price differential we included it in our discussion of direct price divergences.
18. The stipulation that imports could only be financed by sight or acceptance documents was repeated in the *Commercial and Industrial Bulletin* at least twice: 20 March, 1964 and 24 December, 1964.
19. *Commercial and Industrial Bulletin,* 20 December, 1963, quoting from Bank of Ghana Exchange Control Committee notice of 28 September, 1963.

TABLE II-3
Commercial bank loans (excluding cocoa financing) at mid-year (in millions of new cedis)

Year	For imports	Total	Percent for imports
1963*	16.9	77.4	21.8
1964*	9.2	75.8	12.1
1965	10.3	68.4	15.1
1966	24.4	66.1	36.9
1967	17.8	58.3	30.5
1968	15.0	55.5	27.0
1969	12.3	67.9	18.1
1970	25.1	80.3	31.3

Note: * Year end.
Sources: Bank of Ghana, *Report of the Board for the Financial Year Ended 30 June*, 1965 (for 1963–1965); 1968 (for 1966–1968); and 1970 (for 1969 and 1970).

(b) Regulation of credit

The major measures relating to the finance of foreign trade were contained in the credit control regulations introduced on April 1, 1964. The general move to establish credit regulations was clearly part of the evolution of the Bank of Ghana into a full-fledged central bank, so the major thrust of these new regulations was to set out reserve ratios for the commercial banks and to detail their reporting requirements. In addition, however, two features of the regulations were of potentially considerable importance for foreign trade.

The first set out a requirement that credit facilities over N₵ 10,000 for purposes other than agriculture and industry could be made only with the prior approval of the Bank of Ghana.[20] This provided a mechanism for restricting imports by limiting the credit available to those engaged exclusively in the import trade, but could not prevent multi-activity firms such as the big trading companies from shifting funds internally. On the surface the policy appears to have had some initial effect in redirecting credit. Commercial bank loans for the import trade dropped absolutely and relatively in 1964 and maintained a fairly low level in 1965 (see Table II-3). This occurred despite the general lament by the bank of Ghana that "the effectiveness of the quantitative credit control regulations might have been greater if the commercial banks had complied fully with regulations."[21] It is doubtful, however, that the excess demand for imports was substantially reduced by this device.

20. *Commercial and Industrial Bulletin*, 17 April, 1964.
21. Bank of Ghana, *Report of the Board for the Financial Year Ended 30 June*, 1965, p. 82.

(c) Prior deposits

The further device concerning the import trade contained in the 1964 credit control regulations was the establishment of a minor prior-deposit system. The scheme for prior deposits on imports, although relatively insignificant as an element in the array of restrictive instruments, is in many ways typical of a proliferation of instruments bearing on the foreign sector. Further, its history is indicative of the rapidity of change that is often encountered at the height of restrictiveness.

Initially, the system announced in April 1964 was one in which commercial banks were required to obtain and hold a 15 percent minimum down payment before opening a letter of credit for imports of consumer goods, including consumer durables.[22] In June 1964 this was revised by requiring that the margin be deposited with the Bank of Ghana. A further tightening took place in December of the same year; the margin was extended to all imports of consumer goods, regardless of the method of finance, and the deposit had to be made before the specific licence would be issued.[23] This apparently was not fully enforced, for in June 1965 a request appeared, addressed to holders of 1965 specific licences for consumer goods, "to pay forthwith to the Bank of Ghana the mandatory 15 percent cash margin of the value of the licences."[24] And in July 1965 a repeat request appeared, combined with a modification of the procedures – which apparently permitted payment of the deposit after the licence was issued but before the opening of a letter of credit, or within fourteen days of confirmation of an order to be paid by documentary credit.[25] This system continued throughout 1966 and was set out as part of the 1967 licencing procedures announced in July 1966, but was finally scrapped following the devaluation of July 1967.[26]

An assessment of the effect of the prior deposits is difficult because of their constant changes and relatively short duration. What is clear is that they were probably little more than a nuisance for the large importers, as the cost was considerably less than one percent of the c.i.f. value and hence provided little price deterrent to importation.[27]

22. *Commercial and Industrial Bulletin*, 17 April, 1964.
23. *Ibid.*, 24 December, 1964.
24. *Ibid.*, 25 June, 1965.
25. *Ibid.*, 30 July, 1965.
26. The above description is based on the record appearing in the *Commercial and Industrial Bulletin*. However, we have been told that some additional changes and complications took place: for part of 1965 the margin was set at 30 percent, but only one-half of the margin deposited with the Bank of Ghana; for 1966 some small margins were established for raw materials (5 percent) and capital goods (1 percent), but within a few months abolished.
27. Assuming the importer had to borrow the 15 percent margin at 8 percent per annum for three months, the prior deposit adds 2 percent of 15 percent, i.e., 0.3 percent, to his c.i.f. cost of goods.

5. Quantitative restrictions

(a) The setting

Another major set of instruments used to affect the foreign-exchange market consists of direct quantitative restrictions. Such restrictions are designed to place controls on the level and composition of foreign-exchange use. During 1961 three instruments of this type were applied with substantially greater restrictiveness than previously: control of foreign-exchange transactions, licensing of trade in goods, and bilateral trade and payments agreements. While all these instruments had been in use before 1961, they had generally been applied in a liberal manner. Hence, the 1961 move to tighten the quantitative controls on international transactions represented a major shift in Ghanaian economic policy.

Underlying this change was a predilection on the part of President Nkrumah to controls as an allocative device in bringing about the desired structural transformation of the colonial economy. A belief in the efficiency of direct intervention as a solution to all-important economic problems, together with a desire to re-orient the trade pattern, particularly the geographic and commodity composition, resulted in a strong push towards controls by the national leadership. For those in the governing circles with a less interventionist approach, no substitute for controls seemed available. Traditional macro methods had allegedly not worked to dampen the level of foreign-exchange expenditure, and nothing short of controls was apparently available to achieve the generally accepted objective of transforming the existing structure into an unspecified "modern" structure. Hence, a broad temporary coalition developed ranging from those who favored a permanent interventionist role through those who viewed controls as a temporary expedient to be used while the structural transformation of the economy took place, to those who regarded controls as an interim measure until more orthodox methods could be made to work.

In resorting to controls, however, few members of the governing circles distinguished between their capacity to achieve broad allocative objectives and their capacity to allocate in the small. The subsequent proliferation of detailed regulations and the difficulties encountered point up the failure to appreciate this distinction. The assumption made by most was that controls could be implemented: that an objective stated and corresponding instruments announced would ensure the achievement of the objective.

The substantial tightening of controls was precipitated, not so much by a conscious decision to move in that direction, but more in response to a rapidly deteriorating balance-of-payments situation. Export revenues were stagnant.[28] A sharp increase in expenditures on imports of goods and services, due initially to a rapid expansion of aggregate demand,[29] and fed by the dual expectations that the level of foreign-exchange expenditures would be sharply curtailed by controls and that the geographic and commodity composition of trade would be altered by bilateral agreements, produced an intolerably rapid decline in reserves. And, as the inevitability of some form of drastic remedial action became more obvious, the rise in both merchandise and non-merchandise payments accelerated[30] – to the point that during the six months preceding the imposition of stricter exchange control in July 1961 external reserves reportedly fell by more than N₵ 69 million,[31] compared with the December 31, 1960 level of N₵ 297 million. And the decline continued for the rest of the year: reserves dropped by N₵ 150 million in calendar 1961 (Table II-4).

The sequence of events in 1961 also suggests that government officials had done little to prepare a comprehensive set of controls. For example, the initial moves involved the signing of bilateral trade and payments agreements with several socialist and a few African countries, a process which continued throughout the year. Recognizing that the only way to engage in significant trade with socialist countries would be via trade pacts, 16 bilateral pacts were signed in the period May 1961 through January 1962.[32] However, most were not immediately implemented, and complementary policies to ensure that imports obtained under such agreements would be marketed competitively with imports from existing sources were not immediately instituted. The result was a speculative demand for imports from traditional sources which fed the growing speculative demand arising from the expectation of overall

28. However, the contention that the price deterioration in cocoa produced a decline in export revenue is not borne out by an examination of the data for 1961. For an example of this conventional view, cf. Naseem Ahmad, *Deficit Financing, Inflation and Capital Formation, The Ghanaian Experience 1960-1965*, Weltforum Verlag, Munich, 1970, p. 73.
29. See section 6 below.
30. See Table A-3a. Payments for imports, non-factor services, earnings on investments, and transfer payments on current account all increased rapidly in 1960 and 1961.
31. Cited by Ahmad, op. cit., p. 74, from Bank of Ghana, *Report*, June 1962, p. 17.
32. The only previous bilateral trade and payments agreement was signed with Israel in 1958. The agreements were: Israel (5 July, 1958), United Arab Republic (31 May, 1961), Upper Volta (18 June, 1961), Guinea (6 July, 1961), Mali (8 July, 1961), Peoples' Republic of China (18 August, 1961), Rumania (30 September, 1961), Bulgaria (5 October, 1961), Albania (7 October, 1961), Yugoslavia (11 October, 1961), Czechoslovakia (16 October, 1961), German Democratic Republic (19 October, 1961), Hungary (23 October, 1961), Holland (26 October, 1961), USSR (4 November, 1961), Dahomey (20 December, 1961), Cuba (27 January, 1962). Source: IMF, *Annual Report on Exchange Restrictions*, 1959 and 1962.

controls. And the authorities were not immediately in a position to control this demand.

In mid-year, exchange control plus budgetary measures were introduced, apparently in a belated effort to stem the non-merchandise flow via exchange control while relying on internal deflation and slightly higher tariffs to dampen the net outflow on merchandise account. Virtually simultaneously, in July 1961 application of the exchange-control system was widened from non-sterling accounts to include the sterling area, and an allegedly deflationary budget introduced.

The budgetary moves emphasized orthodox measures designed to deal with the payments pressure: emphasis was placed on increased government revenue to contain private demand in general and for imports in particular. The personal income tax net was widened and personal exemptions abolished, rates increased and a withholding system instituted. A compulsory savings plan was also introduced. Finally, a purchase tax and increases in import duty rates were announced.[33]

(b) Exchange control

The widening of the exchange-control net to include the rest of the world may be seen by comparing the nature of exchange restrictions before and after July 1961. Prior to the instigation of universal exchange control, the Ghanaian regulations were not unlike those of other sterling area countries. Visible current account items were subject to licencing and payment restrictions designed primarily to discriminate in favor of the area and protect its overall balance-of-payments position. Imports were subject to licencing, but Open General Import Licences (OGL), which permitted importation without prior authorization, covered virtually all commodities from the sterling area and most other nondollar countries, but only wheat flour from Canada and the United States.[34] Exchange cover for all permitted imports was provided automatically on application. Exports were also subject to licencing, but again with a wide range of items covered by Open General Export Licences. The usual exchange-control requirement to collect (within 6 months of shipment)

33. While the increased duty rates on individual items were substantial, the increase in total collections as a percentage of total imports was not large, yielding only an effective devaluation of the import-exchange rate of less than 4 percent. (See Table II-1.)

34. In March 1960 OGL was extended to cover almost all imports from the dollar area. The previous special treatment accorded wheat flour was apparently designed to maintain a low price for bread, a procedure typical of many West African countries. See, for example, Peter Kilby, *African Enterprise: The Nigerian Bread Industry*. Stanford University Press, Stanford, 1965.

and surrender export proceeds applied only to sales to some non-sterling area countries.

Invisibles transactions were similarly relatively free within the sterling area. Payments to other territories of the area were not subject to exchange control, whereas payments outside required approval, and receipts in specified non-sterling currency were subject to surrender requirements.

On capital account, again no restrictions were placed on movements within the area, but payments to outside and foreign investment from outside the area required Exchange Control approval.[35]

With the institution of universal exchange control in 1961 the discrimination between the sterling area and the rest of the world was largely dropped by extending controls to cover the whole world. Exchange cover for licenced imports was still provided automatically, but exporters to all countries were now subject to the six-month collection and surrender requirements. All invisible payments were subject to specific individual approval, while the magnitudes of those normally approved were limited. All proceeds from invisibles had to be surrendered. All capital movements, both in and out, also required approval. Further, to ensure adequate control over foreign-held balances, Exchange Control began to centralize all foreign exchange balances into the hands of the Bank of Ghana. The results, which in 3 years involved a doubling of the proportion held by the Bank of Ghana, are outlined in Table II-4. In sum, Ghana, rather than the sterling area as a whole, became the unit around which the exchange-control wall was built.

The exchange-control system underwent a variety of changes in the period 1961-1965. Most were the product of a general sorting out of regulations,[36] with occasional reversals of policy evident.[37]

35. Although the official title of the exchange control authorities changed from time to time, we use the current official designation of Exchange Control throughout this book.

36. For example, regulations were introduced to require presentation of manufacturers' and suppliers' invoices (*Commercial and Industrial Bulletin*, 6 September, 1963); and refunds on air tickets outside Ghana were prohibited (*ibid.*, 22 July 1965).

37. Two cases illustrate this point. In 1962 a requirement was introduced that foreign investors must reinvest at least 60 percent of net profits in Ghana, but this was repealed the following year (IMF, *Annual Report on Exchange Restrictions*, 1963 and 1964). A second case involved the surrender of foreign-held balances by Ghanaian residents as specified in the 1961 Exchange Control Act. A reminder appeared in 1962 (*Commercial and Industrial Bulletin*, 4 May, 1962), but in 1963 a "Special Unnumbered Licence" (SUL) category for imports was introduced, permitting individuals to use foreign-held balances to import goods. See Bank of Ghana notice of 28 September, 1963, appearing in *ibid.*, 20 December, 1963. SUL imports did not become a significant portion of total imports, and are therefore omitted from our discussion here.

TABLE II-4
Ghana's foreign-exchange reserves by holder, 1957 through 1964, year end

Year	Bank of Ghana (1) (in millions of N¢)	Other (2) (in millions of N¢)	Total (3) (in millions of N¢)	Percent in Bank of Ghana (1)/(3) (percent)
1957	76.3	270.6	346.9	22.0
1958	78.5	288.0	366.5	21.4
1959	92.6	246.6	339.2	27.3
1960	107.7	189.6	297.3	36.2
1961	86.2	65.2	147.4	58.5
1962	94.5	50.3	144.8	65.3
1963	69.6	17.4	87.0	80.0
1964	65.7	18.1	83.8	78.4

Note: The category marked "Other" includes: Treasury, Cocoa Marketing Board (to 1962), Commercial Banks (negative from 1962), Local Authorities (to 1962), Higher Educational Institutions (to 1962); plus a small additional "miscellaneous" factor.

Source: Bank of Ghana, *Report of the Board for the Financial Year Ended 30 June, 1965.*

Once the sorting out was completed, the system remained virtually static until 1965 when, faced with an out-of-control situation, Exchange Control introduced two new and more restrictive regulations. The time permitted to exporters to collect and surrender their proceeds was reduced from 6 months to 60 days from the date of shipment. Also, in an apparent attempt to squeeze foreign-owned firms for more foreign exchange, a regulation was introduced which required prior Exchange Control approval of domestic loans and overdrafts to resident companies controlled by non-residents. These regulations have remained in force since.

(c) Import licencing

Returning to the situation of 1961, one will recall that budgetary measures and exchange control were introduced in mid-year in an attempt to contain the balance-of-payments pressure. Despite the budgetary measures the central government deficit continued to enlarge (see Table A-5), and aggregate demand pressure on imports was not abated. Further, and probably more importantly, expectations that the net of controls would be expanded to include restrictive licencing of merchandise imports generated substantial speculative demand, particularly for consumer durables, resulting in an increase rather than a decrease in merchandise imports.

By November 1961, the government felt it had only one instrument left to deal with the situation: stringent import licencing. On November 24 the existing licencing system was hurriedly altered, with a switch from a system in which virtually everything was on OGL to one in which the general rule was a specific licence for everything with a very few exceptions placed on OGL.

The new Open General Import Licence list published at the time allowed for importation of only: (1) single copies of books and periodicals addressed to individuals and (2) non-merchandise articles – trade samples, personal effects, and small gifts.[38] All other imports required specific licences.

The licencing authorities then set out to consider the current import needs. Due to the large stocks of imports built up in anticipation of licencing, a highly restrictive policy could be and was followed over the first year of licencing (1962). The overall objective was one of keeping imports to the barest minimum possible. Initially this was pursued on an *ad hoc* basis. As their capabilities to handle applications expanded, the authorities developed procedures for handling various categories and invited applications for specific licences in each category. Beginning with manufacturers' materials and then vehicles, equipment, building materials, textiles, chemicals, consumer non-durables, and so on, dates and procedures for applications were announced. At the same time a few items were added to the OGL list to provide for specific needs (education, sports, water works, agricultural feeds, and seeds), for traditional border trade in livestock and food, for spare parts, and temporarily for essential food items.

The hurried way in which licencing had been introduced and the *ad hoc* nature of the procedures inevitably generated dissatisfaction with the working of the system. Shortages of specific items, together with persistent rumors of corruption in the licencing administration brought the situation to a head, and in late 1962 a commission of enquiry was appointed. While it took over a year to complete its work,[39] the licencing authorities immediately attempted to streamline the day-to-day administration of the system. They also turned their attention to the development of a longer-run system containing the following elements: (a) Expected foreign exchange available for specifically licenced imports was estimated. (b) An import program was drawn up in which available foreign exchange was provisionally allocated among various categories of specifically licenced imports. (c) Importers were registered and classified. Allocations among the categories of specifically licenced imports were based initially on historical shares, with the shares of "non-essentials"

38. A tabulation of annual OGL lists is available from the author on request.
39. The final report is contained in: Republic of Ghana, *Report of Commission of Enquiry into Alleged Irregularities and Malpractices in Connection with the Issue of Import Licences*, Accra, February 1964.

(i.e., items that in the licencing authorities' view could be reduced) scaled down. Importers (but not licences) were of two general types: manufacturers importing for own use, and importers buying for resale. Within each general type importers were assessed on the basis of their historical shares, current size of their operations, payments of taxes, and employment. Licences were then allocated to importers which were specific to that importer and specific in the commodities that could be imported.[40]

Given the relatively small manufacturing sector, the licencing authorities appeared to be able to develop a reasonably clear understanding of local manufacturers' requirements for materials and spare parts, and attempted to meet those requirements. The importers of goods for resale proved to be more of a problem for the licencing authorities. A system involving grades for importers was introduced, with grades ranging from A (large trading firms) through D, based on historical shares of turnover, taxes paid, and employment. Within each grade (except A) firms were allocated approximately equal amounts of foreign exchange. Very soon a fifth grade, E, had to be introduced as the number of "importers" began to grow, arising from both new entrants and a multiplication of old firms. Further, although resale of licences was prohibited, it was impossible to deal with petty instances of the equivalent resale of goods. A common device was for a small recipient of a licence to arrange for a larger experienced firm to handle all aspects of the importation on behalf of the smaller importer – with profits, of course, split between them.

During the early part of the second year of licencing (1963) administration of the system appeared to work reasonably smoothly. Stocks depleted during the previous year were gradually rebuilt, and the OGL list was adjusted to meet apparent difficulties and slightly expanded. Some attempt was also made to limit imports of goods in which import-substitution appeared possible. For example, it was announced in October 1963 that imports of certain kinds of footwear, matches, toilet paper, nails, and plastic utensils were prohibited.[41]

The licencing authority was organized internally with a system of control and records designed to permit efficient handling of applications and at the same time prevent irregularities in the granting of licences. The set of records permitted easy reference to the details concerning an applicant, and the system of controls involved a four-stage procedure in which (1) the allocation

40. Trading in licences and resale of manufacturers' materials were prohibited. Undoubtedly some trading and resale did take place, but a large organized continuing market for licences and materials never developed.

41. See: *Commercial and Industrial Bulletin*, 4 October, 1963. In practice, however, published prohibited and restricted lists were seldom adhered to.

was decided, (2) the allocation approved, (3) the licence issued, and (4) the licence checked against the approved allocation and recorded. In preparation for the 1964 licence year, the procedures outlined above were well underway in the final quarter of 1963.

In late 1963, however, a new Minister of Trade was appointed, Mr. A.Y.K. Djin. He quickly saw the potentialities for corruption inherent in a restrictive licencing system. As the investigative commision appointed after the overthrow of the Nkrumah regime found:

> ...He assumed direct responsibility for the issue of import licences, and no such licences could be issued without his express direction...: licences were issued solely at his discretion, capriciously exercised with the consequent development of a crisis in the import trade and attendant trade malpractices... [He] also embarked on irregularities in the issue of licences and fraudulently exploited the situation created by himself for his own benefit, to the advantage of members of his family and personal friends....[42]

The Commission also found instances of "fraudulent exploitation, corruption and malpractices."[43] For example, a small trading firm under Mr. Djin's direction had received a licence valued at £G 35,000 for 1963, but in 1965 was awarded a licence worth over £G 700,000.[44] Apparently to facilitate the manipulation of the licencing system, the expanded OGL list of 1963 was restricted in 1964. The rest of the government bureaucracy viewed these developments with disfavor. The careful administrative procedures that had been designed to meet the apparent national needs and to minimize capricious discrimination among importers was frequently set aside in favor of Mr. Djin and his associates.

In the first half of 1965 a number of steps were taken in an attempt to reverse the situation created by Mr. Djin. President Nkrumah replaced Mr. Djin by Mr. Kwesi Armah as Minister of Foreign Trade and appointed a further commission of enquiry, which quickly did its work.[45] In addition, a foreign-exchange budget was published for the first time. The only significant result of these moves was a more systematic form of corruption. Mr. Armah, rather than restricting himself to profiting on some licences, proceeded to

42. Republic of Ghana, *White Paper on the Report of the Commission of Inquiry into Alleged Irregularities and Malpractices in Connection with the Grant of Import Licences,* W.P. No. 4/67, Accra, 1967, p. 3.
43. *Ibid.*, p. 3.
44. *Ibid.*, p. 3.
45. Republic of Ghana, Office of the President, *Report of the Commission of Enquiry into Trade Malpractices in Ghana,* Accra, January 1966.

develop a system that would permit him to share in the profit on all licences. As the post-Nkrumah commission reported:

> He [Mr. Armah] introduced the system whereby all applications for import licences had to be addressed to him personally under registered cover and he alone was responsible for processing the said applications... [T]here was open corruption and malpractices in the matter of grant of import licences during this period. Import licences were issued on the basis of a commission corruptly demanded and payable by importers on the face value of the import licences issued. The commission was fixed at 10%, but was in special cases reduced to 7½ or 5%.[46]

The result was that licences were refused for essential commodities in short supply while at the same time Armah "was issuing huge licences to importers for non-essential goods."[47] Again the stated priorities for rationing foreign exchange were being thwarted.

The restriction of the OGL list begun by Mr. Djin was continued. At the end of July 1965 a new OGL list was announced which apparently limited OGL to about the level prevailing when licencing was first introduced in late 1961. And in October 1965 OGL was further restricted in significance with the introduction of a requirement that OGL importers had to apply to Exchange Control before entering into a contract.[48] This system continued until the ouster of President Nkrumah in late February 1966.

(d) Bilateral trade pacts

The licencing system during 1962 and part of 1963 was not well designed to induce importers to purchase from bilateral-pact countries. Licences were valid for importation of the specified items from any country.[49] While official entities were redirecting their purchases, for private importers the only apparent advantage that might be achieved by purchasing from trade-pact countries revolved around payment in local currency to the bilateral account in the Bank of Ghana and the consequent reduction in problems associated with arranging payment to suppliers. This was seldom enough to offset the traditional ties with West European and U.S. suppliers. The result of this situation was a substantial undersubscribing of the bilateral accounts in 1962, yielding a positive net balance in bilateral clearing accounts of nearly N₵ 6 million (see Table II-5). This phenomenon and its meaning were not unno-

46. *White Paper*. 1967, *op. cit.*, p. 4.
47. *Ibid.*, p. 5.
48. *Commercial and Industrial Bulletin*, 1 October, 1965.
49. See, for example, invitation for applications for specific import licences, *Commercial and Industrial Bulletin*, 26 October, 1962: "Items originating in any country except [South Africa and the Portuguese monetary area]," p. 847.

TABLE II-5
Net balances on clearing accounts, 1961 through 1969 at year end (in millions of new cedis).

Year	Net balance	Change over year
1961	0.5	
1962	6.0	+5.4
1963	2.5	−3.5
1964	−1.0	−3.5
1965	−36.2	−35.2
1966	−30.0	+6.2
1967	−8.9	+21.1
1968	−9.9	−1.0
1969	−22.6	−12.7

Source: Bank of Ghana, *Report of the Board for the Financial Year Ended 30 June,* 1965 (for 1961–1963); 1968 (for 1964–1967); 1970 (for 1968–1969).

ticed,[50] and in 1963 specific licences distinguished between trade-pact sources and other areas. In addition imports of certain goods (8 commodities) could be obtained only from those countries, and 20 percent of other specified imports (28 commodities) were to come from trade-pact countries. For 1964 the redirection of licences to bilateral trade-pact countries was strengthened. A special exchange allocation was provided, and a list of 35 commodities developed which permitted purchases only in bilateral-pact countries. Further, in order to discriminate among the various bilateral partners the system of simply distinguishing between bilateral partners as a group and all others was abandoned in favor of specifying the bilateral partner country from which the licenced commodity had to be imported.

These moves succeeded in turning the balance around, so that at the end of 1964 there was a small negative balance, and by the end of 1965 Ghana had succeeded in becoming a net borrower to the extent of over N₵ 36 million. Moreover, the methods employed in 1964 succeeded in redirecting imports from some large negative-balance countries to countries with positive balances. This reduced absolutely the large negative balances with the Peoples' Republic of China (from – N₵ 2.2 million to – N₵ 1.8 million) and the negative balance with Mali (from – N₵ 1.0 million to – N₵ 0.4 million). At the same time the large positive balance with the USSR was substantially

50. *The Economic Survey*, published by the Central Bureau of Statistics (CBS), for 1962, p. 112, noted that "this [credit balance] amounted to the almost ridiculous position of Ghana offering interest-free loans to certain industrialized countries." And *The Economic Survey* for 1963 noted problems with delivery dates and unknown products in the Ghanaian market.

reduced (from N₵ 4 million to N₵ 2.6 million).[51] The discrimination between bilateral-pact countries and others, as well as among bilateral-pact countries, continued until well after the coup.[52]

(e) Consequences of the system under the Nkrumah government

The tight application of quantitative restrictions during the last four years of the Nkrumah government (1962 through 1965) failed to achieve what must be regarded as its primary objective – reducing the substantial negative balance of payments on goods and services. Although highly variable, the net balance of payments on goods and services remained strongly negative over the period (see Table A-3a). On the import side, the share from bilateral trade-pact countries had increased by over ten percentage points (see Table A-4b). Shares of imports by end-use had been redistributed away from consumer goods and to increases in the shares of materials and capital equipment (see Table A-4a). On the export side, the overall dependence on staple primary exports continued, with commodity concentration rising slightly. New markets, particularly for cocoa, were opened in the trade-pact countries, resulting in a minor reduction in geographic concentration.[53] It did, however, have the advantage of permitting Ghana to expand the output of cocoa without seriously weakening the price obtained. Financing of the current account deficit was done largely via contracting external debt. While small amounts of private foreign capital were received over the period and reserves were further depleted, the great bulk of the funds which permitted the large current deficits were obtained by entering into debt. By the time of the coup in February 1966, the external debt totalled N₵ 805.3 million, of which only 20 percent was in the form of long-term loans. The remainder was made up in large part by suppliers' credits (57.9 percent),[54] arrears of current payment (10.6 percent), and bank loans (6.5 percent) (Table II-6). This legacy was to create serious problems for subsequent governments.

The system was also generating considerable internal dissatisfaction. Again a commission of enquiry was appointed (April 1965), although on this occasion the focus was more broadly defined to include a variety of trade "mal-

51. See Bank of Ghana, *Report of the Board for the Financial Year Ended 30 June, 1965*.
52. Unfortunately no careful assessment of the relative benefits and costs of the trade-pact experience has yet been published.
53. See J.C. Leith, "Export Concentration and Instability: The Case of Ghana," *op. cit*,; and J.C. Leith, "The Competitive Performance of Ghanaian Exports in the Nkrumah Period," *Ghana Social Sciences Journal*, Vol. 1, No. 1, May 1971.
54. The unfortunate experience Ghana had with suppliers' credits is described in L.E. Grayson, "The Role of Suppliers' Credits in the Industrialization of Ghana," *Economic Development and Cultural Change*, Vol. 21, No. 3, April 1973.

TABLE II-6
External debt (other than private) as of February 23, 1966 (in millions of new cedis, postdevaluation)

Type	Value	Percent
Long-term loans	161.4	20.0
Suppliers' credit	466.1	57.9
Arrears	85.3	10.6
Banking loans	52.7	6.5
IMF	8.9	1.1
Other	30.9	3.8
Total	805.3	100.0

Source: Republic of Ghana, Statement by E.N. Omaboe, Commissioner for Economic Affairs, *Developments in the Ghanaian Economy between 1960 and 1968*, Ghana Publishing Corporation, Accra, undated (published for the election campaign period in mid-1969).

practices," such as the internal distribution system. The report,[55] presented shortly before Nkrumah's overthrow, found a variety of cases in which shortages of imports created difficulties. The State Paints Corporation closed between May and July 1965. Agricultural inputs (fertilizers and machetes) were frequently in short supply. A factory under construction was unnecessarily delayed because of import delays. And considerable corruption was exposed.[56]

Criticism was not confined to the official enquiry. The annual *Economic Surveys* issued by the Central Bureau of Statistics contained strong indictments, couched in diplomatic language, of the undesirable consequences of inadequate supplies of raw materials and of shortages of essential food items.[57] Similarly, the Planning Commission expressed open concern about the consequences of spare parts and raw material shortages.[58] Further, an unpublished study cited by Killick estimated that in 1964 manufacturing capacity utilization was at about 60 percent of single-shift capacity.[59]

55. Republic of Ghana, Office of the President, *Report of the Commission of Enquiry into Trade Malpractices in Ghana, op. cit.*
56. For a review of the Commission's report, emphasizing the internal trading aspects, see Rowena M. Lawson, "Inflation in the Consumer Market in Ghana: Report of the Commission of Enquiry into Trade Malpractices in Ghana," *Economic Bulletin of Ghana*, No. 1, 1966, pp. 36-51.
57. See CBS, *Economic Survey*, 1964, p. 77; 1965, p. 75.
58. Office of the Planning Commission, *Annual Plan for 1965*, Accra, 1965.
59. Tony Killick, "The Purposes and Consequences of Import Controls in Ghana," mimeograph, Accra, 1972.

By 1965, faced with growing criticism of the system at home, the government turned to the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), but received little more than affirmation of the apparent. As the commentator in the *Economic Survey* for 1965 noted:

> The Fund Mission's Report confirmed what has been obvious to most observers all along. The Report stated that "the Ghana economy is severely overstrained, the balance of payments is in serious deficit, and the country's foreign exchange reserves are at a precariously low level. Foreign debt repayments are increasing, putting added pressure on the balance of payments."[60]

In a similar vein, the response of the IBRD called for strong medicine.

> The World Bank Mission recommended "a restoration of the balance between government revenue and expenditure" stating that "such action would hopefully be regarded by all sectors of the world financial community as constituting a determined effort on your part and deserving of their assistance in complementing the efforts of your government."[61]

The situation was serious. Heavy borrowing by Nkrumah plus a further depletion of foreign-exchange reserves had been used to finance the import binge of 1965. Predictably, these sources were quickly drying up. With a short- and medium-term external debt totalling N₵ 645 million (Table II-6) – nearly two times annual export earnings – and reserves of only N₵ 26 million (Table A-3b), Ghana's credit was nearly exhausted. The prospect for 1966 was not good, for even with a reliance on normal export earnings, current account expenditures would have to be cut by about 35 percent from the 1965 level if further borrowing and reserve depletion were to be avoided. In itself this was a very serious situation. Compounding the difficulties was a glut on the cocoa market, and total merchandise export earnings were falling. The 1966 returns eventually showed a 13 percent decline in merchandise exports from 1965 to 1966. A drastic cutback of imports, and hence real income, was required. Licencing was again tightened.

(f) Stabilization

The difficulties experienced in the economic sphere contributed in no small way to the political events of early 1966. February 24, 1966 marked a major change in the political, social and economic life of Ghana. A military coup replaced the regime of President Nkrumah with a National Liberation

60. *Economic Survey*, 1965, p. 50.
61. *Ibid.*, p. 51.

Council (NLC). The new government set itself the task of national reconstruction which, in the economic field, involved an austerity or "stabilization" program designed to bring both the foreign and government sector accounts into balance again.

In dealing with the foreign sector, the NLC government severely restricted the overall level of foreign exchange available for imports and attempted to allocate foreign exchange among competing demands on a basis that it regarded as systematic and rational. The former was relatively easily accomplished once the licencing system was reorganized to resemble the system developed in the earlier years. The latter objective, faced with the inevitable conflict among competing "rational" uses of a rationed item, together with the delays inherent in a system designed to prevent abuse, was not as readily achieved.

The system that emerged during 1966 emphasized fair and open treatment of applicants while at the same time attempting to meet the objective of mobilizing domestic resources and ensuring an adequate and cheap supply of essential commodities for consumers.

The overall foreign-exchange budget was struck by the Bank of Ghana, and in turn allocations were made to the various ministries responsible for specific allocations of licenses:

Ministry of Trade -- commercial imports,
Ministry of Industries – imports for private industrial use,
State Enterprises Secretariat – state industrial enterprises,
Ministry of Economic Affairs – government imports.

The final issuance of licences remained with the Ministry of Trade, and the resulting allocations were published in the *Commercial and Industrial Bulletin* for all to see.[62] Of major interest and importance are the procedures adopted for private commercial and for private industrial imports.

The system of grading commercial importers established in the early days of import licencing was retained. However, a complete revision of the register of commercial importers was undertaken. Grades were assigned according to past volume.[63] Importers with N₵ 2 million annual volume over the period 1961 to 1965 were assigned the top grade. The remaining grades ranged from importers with an annual volume of N₵ 100,000 to those with N₵ 20,000

62. The allocations were published in such a way, however, that it is impossible to distinguish among allocations for commercial, industrial or governmental use.

63. This, of course, tended to perpetuate inequities that had developed over the years, excepting only the extreme cases that were the subject of the official post-coup inquiry.

volume. Within each grade commercial importers were assigned approximately equal foreign-exchange allocations. The objective in this approach was to "obtain goods on competitive terms and at reasonable prices to the consumers,"[64] hence the reliance on larger firms with proven trade and financial contacts and facilities to ensure that the country had adequate supplies of essential commodities.

Private industries' requirements for imported materials new equipment and spare parts were assessed by the Ministry of Industries. Again, a system of various categories was employed which reflected the conflicting objectives of protection of the consumer (hence a high priority given to imports for use by producers of essential consumer goods), of export promotion (with consequent high priority for export industries), and of import-substitution (also a high-priority category). From the given allocation of foreign exchange assigned it, the Ministry of Industries first divided the available foreign exchange among the categories and then attempted to make *pro rata* allocations among firms within a category based approximately on previous market shares but taking into account their assessment of the firms' "performance" in such things as employment, taxes paid, and what was called general efficiency of operation. While there is no evidence of corruption during this period, the bureaucrats' assessment of performance inevitably resulted in some arbitrary allocations.

The import-licence system, since it had virtual life and death powers over most industries, came to be used as an industrial licencing system as well. The Ministry of Industries saw a conflict between the need for competition among domestic producers and the wasteful expenditure involved in duplicating underutilized domestic facilities, but generally resolved it during the NLC period in favor of "rationalization" of industries and against new entrants.

The post-coup review of the licencing machinery also brought an attempt to alleviate the very serious shortages that had developed in the later Nkrumah era and which had resulted in empty shops, as well as idle factories due to the lack of imports. The OGL list for 1967 was expanded a little over that of 1965 and 1966, and the administrative system was designed to permit the issuance of licences in advance of the year for which they would be valid – in contrast with the 1964 and 1965 experience of licences often being issued very late in the year for which they were valid. A schedule for submission of applications for 1967 licences was set up, with applications for essentials (flour, sugar, rice, milk, butter, tinned fish and meat, and other meat) being called for in August, spare parts and raw materials in September, etc., with the objective of having licences for virtually all foreseeable imports

64. *Commercial and Industrial Bulletin,* 7 October, 1966, p. 778.

issued before the beginning of the calendar year in which they would be used. In practice, however, it was difficult to achieve this, for there was typically some delay in striking the overall foreign-exchange budget and, in turn, delay in sifting through the multi-staged allocational process which preceded the specific firm allocations.

The system as it emerged and was applied in 1967 was substantially more open and less corrupt than the chaotic state of affairs which had prevailed in 1964 and 1965. Within the tight foreign-exchange budget, the licencing authorities did attempt to allocate licences in a way that reflected their perception of national needs and, subject to this constraint, avoided serious discrimination between individuals. It does not follow, however, that the system was necessarily any less arbitrary than in the late Nkrumah period.

(g) Liberalization

The worst abuses of the late Nkrumah period apparently had been removed. Yet the interventionist approach to allocation remained, and this too was being called into question. A growing belief developed among policy-makers that import licencing was not a long-run solution to the Ghanaian foreign-exchange problem.[65] Pressure to pursue a liberalization of licencing was also brought to bear on the government from both outside the country by bilateral donors and international agencies, and by internal dissatisfaction with licencing. As a consequence, a tentative commitment to long-range liberalization developed.

The first major steps toward a liberalized trade and payments regime were taken in the third quarter of 1967. A substantial devaluation of nearly 43 percent was introduced in July, together with some import duty and export tax reductions. Accompanying the devaluation was an announcement of an expanded OGL list. The net result was that 3 percent of all imports came under OGL for calendar year 1967, and over 18 percent of all imports in 1968.[66] Progress was also made in mopping up the massive foreign-exchange payments arrears that had accumulated prior to the coup (Table II-6 above), so that by the end of 1967 foreign-exchange cover had been provided or special arrangements had been made for virtually all arrears that had been pending in early 1966.

The import-liberalization process is considered in more detail below (Chapter V). In terms of the present narrative, the important point to note is that the process of import liberalization was a gradual one in which the licencing system was retained intact, albeit somewhat shrunken in magnitude. While by

65. The evident dissatisfaction in official circles is illustrated by the sniping at the system during the late Nkrumah period cited in article (e) above.

66. See Table V-11 below.

the end of 1970 the OGL system had expanded to cover 60 percent of all imports and a much higher proportion of essential consumer and producer goods, the system governing import licencing remained much the same as the system that had developed in the early years. The foreign-exchange budget was struck, an import program drawn up taking into account recent shares of imports by end-use plus expected OGL imports, and a block of foreign exchange assigned to each of the Trade and Industries divisions for allocation to commercial and industrial importers respectively.[67]

Commercial imports subject to specific licencing, which now constituted nearly all the specifically licenced imports, were allocated by the Trade division first among 56 classes of goods and second among registered importers. The detail of the commodity classification varied from the SITC three-digit to the six-digit level. Some items, such as fuels and lubricants and essential consumer goods not yet assigned to the OGL list, would be automatically allocated sufficient foreign exchange to meet expected demand, while the remaining foreign exchange was divided among the residual items. The allocation to firms continued to be based on the grading system with the top-grade firms handling about 60 percent and virtually the entire range of licenced commercial imports.[68] It was on these firms that the government continued to rely to keep imports flowing smoothly. A major limit on the share of licences going to grade-A firms appears to have been the extent of their financial capacity to handle imports. In the lower grades firms were allocated licences for only those few commodities in which they specialized. Typically, all firms within a grade would receive about equal allocations, although some attempt was made to distinguish among the medium-sized firms on the basis of their overall turnover, local commodity sales, employment and tax payments. However, to minimize suspicion of favoritism on their part, the licencing authorities clearly preferred to assign a flat rate to each importer within a grade and departed from that only when there was clear evidence of superior "performance," such as employment.

While the administrative apparatus remained essentially unchanged in its procedures and intent from the original system developed in the early part of the decade, a number of other elements of the system had changed. First, there was now a continuing process of foreign-exchange budgeting, involving

67. Commercial imports covered nondurable consumer goods, durable consumer goods, fuels and lubricants. Industrial imports covered nondurable producers' goods, durable producers' goods, and producers' equipment.

68. Ghana National Trading Corporation, the large state-owned trading company continued to receive a somewhat larger share than the other grade-A firms because of its obligation to carry larger stocks and broader ranges of imported goods. However, it continued to experience a decline in its share of total imports.

the preparation of forecast receipts and programmed imports. While attempts to develop a foreign-exchange budgeting system had begun in the late Nkrumah period, the budgets prepared for 1965 and 1966 were little more than scraps of paper.[69] Only after the coup was any serious attempt made to implement a foreign-exchange budget. Prompted by the need to present a coherent case for aid to donor countries, foreign-exchange budgets were drawn up and published beginning in 1967.[70] However, even these attempts were far from successful. Tony Killick has provided some interesting comparisons of programmed and actual imports for the years 1968 and 1969.[71] The budgets were regarded as targets, both for the level and the composition of foreign-exchange use. In both years, non-durable consumer goods imports exceeded programmed imports by substantial margins, while actual producers' materials imports fell short of the programmed values. And, in looking at specific items he found typically wide differences between actual and programmed values. He concluded that "the import programmes were only very loosely implemented when it came to details and this and other factors resulted in an actual detailed composition of imports that bore only the most approximate relationship to the intentions of the planners."[72] The allocation of licences was not, apparently, closely geared to the target budgets.

Second, promotion of small Ghanaian businesses became one of the objectives of a variety of government policy instruments, including the import-licencing system. As early as October 1966, in the exercise of reviewing the register of importers following the coup, special consideration was given to small Ghanaian importers. Some 763 Ghanaian importers were initially struck from the register because their volume fell below the N₵ 20,000 per annum minimum required for the lowest grade, but they were quickly reinstated.[73] Similarly, in the post-coup period the transfer of licences between firms and between commodities remained illegal under the threat of fines and deregistration. However, a licence once issued could now be returned for endorsement to another importer, thus permitting small firms to import via a larger firm with established buying and credit connections. The endoresment procedure, however, was open only to small Ghanaian firms. In other words, the licencing system was also being used to promote the Ghanaianization of small

69. The 1965 central government budget contains the first published foreign-exchange budget, and a similar document was prepared for 1966 (prior to the coup).
70. Republic of Ghana, *Ghana's Economy and Aid Requirements in 1967*, Accra, 1967. Similar titles were used for the 1968 (Accra, 1968) and the January 1969–June 1970 documents (Accra, 1969).
71. "The Purposes and Consequences of Import Controls in Ghana," *op. cit.*, Accra, 1972.
72. *Ibid.*, pp. 22-23.
73. See *Commercial and Industrial Bulletin*, 7 October, 1966.

businesses, thus adding a further objective to an already overburdened instrument.

Third, as the OGL list expanded to include most producer materials and equipment it became evident that import licencing could no longer be used as an industrial licencing instrument. The Minister of Trade and Industries responded with the Manufacturing Industries Act, which came into force in April 1971. The Act provided for licencing of new or expanding manufacturing activities, and enabled the Minister to issue instructions and regulations for any manufacturing industry "relating to the quality, quantity and prices of products."[74]

Fourth, the extent to which the licencing system effectively discriminated between luxury "inessentials" and less luxurious "essential" commodities was impaired by the liberalization of licence allocations. Licence categories were broadened and the number reduced to the point that in 1971 non-OGL commercial import licences were allocated among only 56 categories. Without a corresponding adjustment of the tariff (which discriminates between commodities at a much finer level of detail) or of the sales tax system, the result of these developments was a substantial increase in imports of more luxurious consumer goods.

Finally, the rapid expansion of the OGL list from 1968 was not generally used to reduce protection of domestic producers. On the contrary, accompanying the expanded OGL list, which emphasized liberalization of materials, equipment and spare parts imports, was a list of restricted/prohibited imports amounting to some 80 or more customs items. Without a corresponding increase in excise tax rates (applicable to domestically produced goods only), the net protection of many domestic producers was probably increased.[75] While this approach represents an import-substitution orientation of the licencing system, there is little evidence that it constituted a major justification of licencing. Rather, given the existence of licencing, the development of a restricted/prohibited list was primarily an *ad hoc* response to pressure by domestic manufacturers already engaged in production.[76]

74. *Manufacturing Industries Act,* Act 356, 1971, paragraph 8.
75. Prior to 1965 individual announcements of restricted/prohibited items had been made from time to time, but for 1966 a list published in October 1965 pulled together previous prohibitions, including various kinds of textiles and footwear. A similar list for 1967 consisted of 81 items. (See *Commercial and Industrial Bulletin,* 19 July, 1966.) Subsequent lists were all of approximately the same magnitude.
76. The theme of protection for import-substitution is taken up again in Chapter III.

6. *Aggregate demand, domestic prices, and trade*

We consider now a different set of instruments, those affecting aggregate demand in the domestic economy. In contrast with the instruments discussed so far, the aggregate instruments are not designed to single out particular activities in the domestic economy, but rather to act on the total level of domestic activity. This is not to say that given other policies the effects are likely to be neutral between sectors. Rather, the focus is on the total balance in the economy.

(a) Aggregate demand and domestic prices

The process of achieving aggregate balance of national income and expenditure may be described as the way in which the economy moves towards the equilibrium:

$$Y \equiv C + I + X - M \qquad \text{(II.3)}$$

The variables in this well-known identity are net output (Y), consumption expenditure (C), net investment expenditure (I), exports (X) and imports (M). They are all value flows of goods and services per period in current prices.

In general, the potential supply of output depends on the productive resources available to the economy. Expenditures on output are determined by a great variety of factors, including the instruments of fiscal and monetary policies. Unless there is a significant gap between actual and potential output, the real level of output is unaffected by the magnitudes of the variables on the right-hand side of equation (II.3). Hence the response to increased expenditure must involve some adjustment via an increase in imports and in the price of domestic output or a reduction in the value of expenditure components.

The nature of the adjustment depends largely on the country's trade and payments system. If the system permits a free flow of trade and payments without quantitative restrictions, then for a small country the domestic price level of tradeables is linked directly with international prices of the same goods. Under these circumstances aggregate demand pressure, *ceteris paribus*, is vented largely on the external balance with increased imports and decreased exports: the domestic price level of tradeables is given by international prices. If, however, adjustment via the external balance is blocked by some mechanism such as controls over imports, the link with international prices is cut. Aggregate demand pressure is vented on the domestic price level to bring about the adjustment, leaving an unsatisfied excess demand for imports. As the domestic price level moves out of line with the international price level, the unsatisfied excess demand for imports is exacerbated and, to the extent that export supply depends on relative prices, exports fall off.

Ghana has experienced both of these types of adjustments to aggregate demand pressure.[77] In 1959, responding to the desire to speed development, the government incurred a substantial deficit (see Table A-5), creating an excess of total expenditure over output. With a fixed exchange rate and a relatively free system of international trade and payments, the adjustment came about largely in the form of increased imports of goods and services, which jumped by more that one-third in 1959. The excess demand for real resources in general was thus turned into a demand for foreign goods and services. This demand was met via a current account deficit, which was accomodated by drawing on foreign-exchange reserves and external capital account borrowing, largely on the part of the government. At this stage, then, the pressure was largely vented on the external balance and not on domestic prices.

The capital account balance turned strongly negative in 1961, while the current account balance moved into an even larger deficit position. In that year reserves dropped from N₵ 297 million to N₵ 147 million. Such a reserve loss was clearly not sustainable. At some point the home excess demand for real resources at the fixed exchange rate would be resisted by foreigners. In the absence of any action by the home government, the foreigners' response would ultimately have been to charge a higher price for foreign exchange, either directly by not accepting the official exchange rate, or indirectly adjusting the prices of tradeables and refusing credit on capital account. The result for domestic residents would have been a movement up along the domestic excess demand curve for foreign exchange.

For the home government, if it were to avoid allowing the foreigners to make the adjustment for them – and failing a change in the official exchange rate – some device had to be found to close the deficit. The options included: (a) a reduction in the overall excess demand for resources in general and hence for external resources in particular; (b) an increase in the effective domestic price for foreign exchange; or (c) a system of non-price rationing of foreign exchange. Initially, a combination of all three was chosen. One recalls from section 3 above that in 1961 an attempt was made to institute deflationary policies, taxes on imports were increased, and the non-price rationing of foreign exchange via exchange control and import licencing were drastically tightened.

77. We are not here considering the implementation of fiscal and monetary policies. The reader is referred to W. Birmingham *et al.*, *op. cit.*, and to N. Ahmad, *op. cit.*, for detailed discussions of the workings of the fiscal and monetary system.

By choosing to employ non-price rationing as one of the devices to close the external deficit, the policymakers instituted an important change that was not perhaps fully understood at the time. Pressure of domestic excess demand would now be vented largely on the domestic price level, permitting it to get out of line with international prices. Failure to control aggregate demand would now show up as higher domestic prices rather than as a loss of reserves.

TABLE II-7
Price deflators of national accounts components (1960 = 100).

Year	GDP minus exports of goods & non-factor services	Exports of goods and non-factor services	Imports of goods and non-factor services	GDP
1956	93.23	93.58	96.73	91.97
1957	97.50	89.45	97.69	92.32
1958	97.22	123.85	96.73	101.11
1959	96.87	110.09	99.60	100.11
1960	100.00	100.00	100.00	100.00
1961	108.96	88.41	101.24	103.20
1962	119.60	74.07	95.74	105.40
1963	127.15	75.97	92.95	112.48
1964	134.38	91.14	104.04	123.70
1965	174.29	75.45	107.43	144.60
1966	195.04	71.57	102.89	161.10
1967	179.05	92.01	128.76	156.93
1968	197.21	128.12	141.04	179.90
1969	208.43	153.43	147.02	195.63

Sources: 1. Current prices: GDP
1956 through 1959, *Economic Survey*, 1967;
1960 through 1962, *Economic Survey*, 1968;
1963 through 1969, *Economic Survey*, 1969.
Exports of goods and non-factor services
1956 through 1959, *Economic Survey*, 1967;
1961, *Economic Survey*, 1968;
1960, 1962 through 1969, *Economic Survey*, 1969.
2. Constant prices: GDP
1959 through 1969, *Economic Survey*, 1967 and 1969;
1956 through 1958, Birmingham *et al.*, *The Economy of Ghana*, Vol. I, p. 50.
Exports of goods and non-factor services
1956 through 1958, Birmingham *et al.*, *The Economy of Ghana*, Vol. I, p. 50.
1959, *Economic Survey*, 1967;
1961, *Economic Survey*, 1968;
1960, 1962 through 1969, *Economic Survey*, 1969.

In the absence of compensatory increases in the nominal effective exchange rates facing exporters and importers, the prices of tradeables relative to non-tradeables would become cheaper and cheaper. This, in fact, is what did happen (from 1960 onwards). Looking at the domestic component of the GDP deflator (GDP–X), we find that by 1966 it had reached an index of 195, compared with an f.o.b. export index of 75, and a c.i.f.-plus-duty import index of 102 (Table II-7, 1960 = 100).

There was little explicit recognition of the problems created by this approach for either exports or imports. With the rising domestic price level, offsetting action on both the export and import sides was required to maintain relative prices at the pre-1960 situation. When such action was either not forthcoming (exports) or inadequate (imports), the already serious aggregate imbalance on external account was exacerbated by increasingly inappropriate relative prices in the domestic economy. The remainder of this section is thus devoted to a discussion of the consequences of aggregate imbalance and domestic price inflation for exports and imports. Our discussion is confined to the pre-devaluation period, as the response to a major shock such as the 1967 devaluation may well be different. These latter issues are taken up in Chapter V below. For an overview of major trends of imports, non-cocoa and cocoa exports, together with the corresponding price-level-deflated effective exchange rates, see Chart II-2.

(b) Exports

We consider first non-cocoa exports, which typically account for 35 to 40 percent of total merchandise export earnings. We have computed the price-level-deflated effective exchange rate facing these exports (Table II-8). It is clear that the nominal effective exchange rate facing non-cocoa exports was not kept in line with the domestic price level.[78] At the same time there was the continuous[79] decline in non-cocoa exports valued in constant prices detailed in Table II-9. These data, together with the price-level-deflated effective exchange rate series from Table II-8, permit us to examine explicitly the response of non-cocoa exports to the relative price facing them. To do so, we estimated the equation:

$$\ln \text{N}\text{¢}X_t = \alpha + \beta \ln (\text{EER}X/P)_{t-\frac{1}{2}} + u_t \qquad \text{(II.4)}$$

78. A minor attempt was made to introduce an export incentive scheme for manufactured goods. It was announced that, effective January 1, 1966, exporters of manufactured commodities would be provided with additional import licences. This scheme was abolished shortly after the coup of February 1966. See IMF, *Annual Report on Exchange Restrictions*, 1966 and 1967.

79. Prior to 1961 there had been a continuous rise, averaging about 7.0 percent per annum (compound) over the period 1955 through 1960.

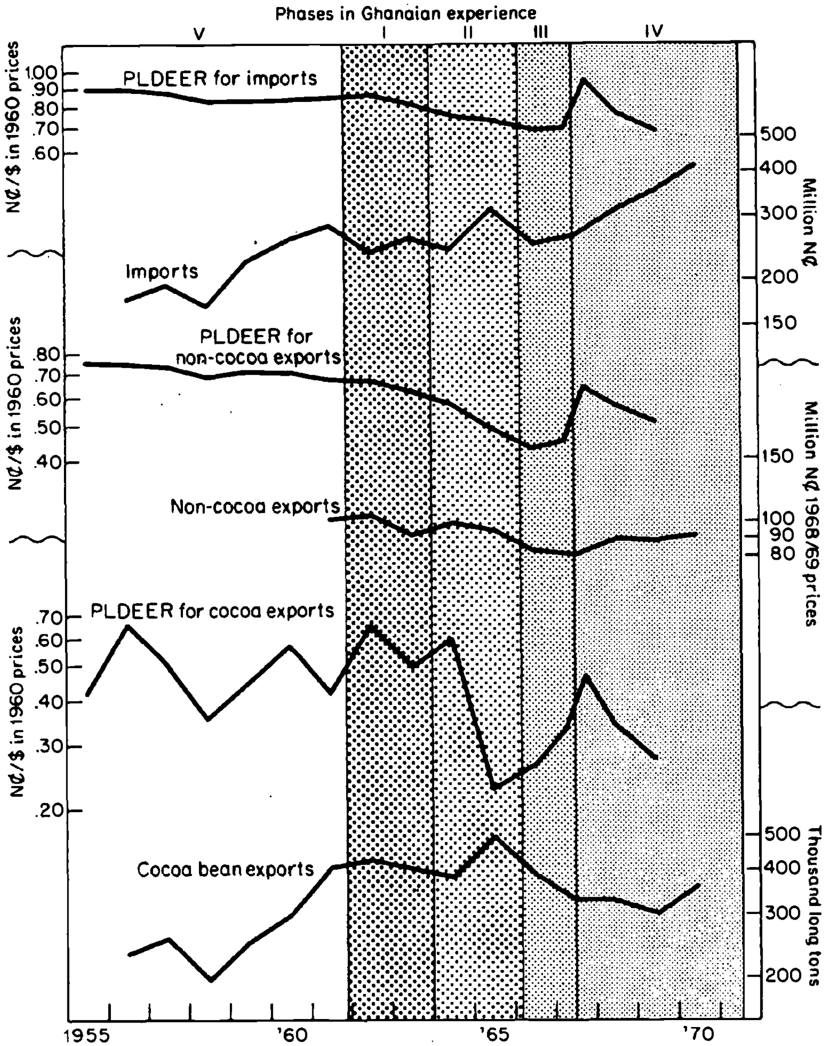

Chart II-2

where N₵X = the value of non-cocoa domestic exports in constant 1968–1969 prices, millions of N₵, from Table II-9, and EERX/P = the price-level-deflated effective exchange rate facing non-cocoa exports, N₵/$ from Table II-8. The results, using ordinary least squares, for t = 1961–1962 through 1966–1967

TABLE II-8
Price-level-deflated effective exchange rates facing imports and exports (new cedis per dollar in constant 1960 prices)

Year	For imports	For non-cocoa exports	For cocoa exports
1955	0.8888	0.7486	0.4194
1956	0.8912	0.7477	0.6602
1957	0.8798	0.7372	0.4958
1958	0.8229	0.6882	0.3529
1959	0.8232	0.7009	0.4490
1960	0.8359	0.7007	0.5737
1961	0.8457	0.6791	0.4172
1962	0.8653	0.6679	0.6503
1963	0.8169	0.6254	0.4907
1964	0.7516	0.5693	0.5948
1965	0.7307	0.4884	0.2259
1966	0.6893	0.4386	0.2634
1967A	0.6910	0.4512	0.3279
1967B	0.9590	0.6449	0.4685
1968	0.7747	0.5636	0.3366
1969	0.6909	0.5188	0.2712

Sources: Computed from effective exchange rates of Tables II-1 and II-2, and the GDP deflator of Table II-7.

$$\ln \text{N¢}X_t = \underset{(9.89)}{2.778} + \underset{(6.28)}{0.4359} \ln (\text{EER}X/P)_{t-\frac{1}{2}}$$

Observations = 6
$R^2 = 0.908$
D.W. = 1.91, t-values in parentheses.

Even this limited number of observations permits us to see that there was indeed a close relationship. The estimated equation explains over 90 percent of the variance. The coefficient for the price-level-deflated effective exchange rate, significant at the 0.005 level, shows the elasticity to be sufficiently large to merit attention: the response to a 10 percent decline in the price-level-deflated effective exchange rate was a 4.36 percent decline in non-cocoa export earnings valued in constant prices.[80] Clearly, the continuing neglect of

80. A regression of current non-cocoa exports on current price-level-deflated effective exchange rate yielded a lower elasticity and a lower R^2. A regression on the price-level-deflated effective exchange rate lagged one year also had a lower R^2, but a slightly higher elasticity. We have deliberately excluded the pre-1961 period from our regression because we are concerned about the response within the context of the control system.

TABLE II-9
Non-cocoa domestic exports, constant 1968–1969 prices, 1961–1970 (in millions of new cedis)

Calendar years (January through December)		Fiscal years (July through June)	
1961	100.1		
1962	103.6	1961/62	100.2
1963	91.8	1962/63	97.6
1964	99.8	1963/64	99.7
1965	94.3	1064/65	96.5
1966	83.3	1965/66	88.8
1967	80.4	1966/67	81.6
1968	89.5	1967/68	86.1
1969	88.0	1968/69	85.3
1970	90.6	1969/70	87.4

Notes: The data consist of all the traditional non-cocoa exports including timber, gold, bauxite, manganese, and diamonds, plus a number of minor exports, but exclude Valco aluminum exports. Some few minor items, such as lime juice, amounting to about 10 percent of non-cocoa exports, are not included because of incomplete quantity data.

Source: Computed by J.J. Stern, mimeograph, Accra, March 1972.

the relative price facing this large segment of exports resulted in a serious deterioration of export earnings.

Cocoa exports are more complex to explain. They have long provided the major share of Ghana's foreign-exchange revenues. Since the mid-1950's cocoa has accounted for about 60 percent of merchandise export receipts and has been a major source of stability in those receipts.[81] However, because of Ghana's major position in the world cocoa market and because of the long gestation period for new plantings, the policy options for cocoa are considerably more complex.

Ghana's substantial share of the world output has a number of implications. Ghana cannot take the world price as given: she has a significant effect on it, and hence the cocoa export tax is intended to move the price in Ghana's favor. Recent econometric estimates suggest that the demand elasticity facing Ghana is (absolutely) greater than minus-one in the long run. For example, the work by Blomqvist and Haessel, using a distributed lag model, suggests that the long-run demand elasticity facing Ghana is on the order of −1.4.[82] Thus a long-run expansion of output would increase Ghana's revenue

81. See J.C. Leith, "Export Concentration and Instability: 'The case of Ghana," *op. cit.*

82. A.G. Blomqvist and Walter Haessel, "The Price Elasticity of Demand for Ghana's Cocoa," *Economic Bulletin of Ghana*, Second Series, Vol. 2, No. 3, 1972. The estimate of −1.4 is based on a market share of 30 percent.

from cocoa exports. However, in the shorter run the demand elasticity facing Ghana is somewhat less (absolutely) than -1; consequently, a sudden expansion of quantity sold would lead to a decline in revenue. This is a problem, particularly in bumper crop years, as was the case in 1965; while the immediate price decline is ameliorated by purchaser stock piling, prices are depressed in subsequent years until the excess inventories are worked off.

Several factors enter into the supply side. Since the late 1930's the prices paid to producers have been set by the Cocoa Marketing Board, which also has legal monopsony powers. This price is usually set and held for a year or more at a time, but has historically moved in response to the broad trends of the world cocoa price.[83] Estimates of the short-run response to the real producer price have yielded elasticities of the order of + 0.15 to + 0.20.[84] These represent the response of harvesting and maintenance and do not take into account the effect of additional planting. The gestation period to full bearing for cocoa trees is currently 7 or 8 years, and hence the long-run response involves adjustment of the stock of trees. The estimates of long-run price elasticity of supply range from + 0.71 to about 1.0.[85] The long-run response relationship, however, is further complicated by the fact that there is a minimum real producer price below which no new plantings take place.

Other factors also have major effects on supply. In the short run, excessive rainfall and humidity during the late maturing stage of the pods can damage the crop, while later rainfall builds up more moisture reserve to carry the growth through the harmattan (dry season). In the longer run, the capacity is favorably affected by insecticide use, which keeps young trees healthy.[86]

A further complicating element in the cocoa policy determination is the implicit conflict among the producer interests, the government revenue interests, and perhaps the national welfare interest. Thus, given the elasticities cited above, an increase in the real producer price would eventually increase Ghana's export revenues. However, such a producer price increase would raise producer incomes more than the increased export revenues, and would in-

83. See P. Ady, "Supply Functions in Tropical Agriculture," *Bulletin of the Oxford Institute of Statistics*, Vol. 30, No. 2, May 1968, Chart 2, p. 165.
84. See M.J. Bateman, "Supply Relations for Perennial Crops in Less Developed Areas," in C.R. Wharton, ed., *Subsistence Agriculture and Economic Development*, Aldine, Chicago, 1969, p. 251; and Bateman's more recent unpublished work on Ghanaian cocoa: "Cocoa Study," in IBRD, *Economic Report*, Vol. IV, mimeograph, Washington, D.C., March 1972.
85. See Bateman, "Supply Relations for Perennial Crops in Less Developed Areas," *op. cit.*
86. Bateman, in his "Cocoa Study," *op. cit.*, estimates that about one-third of the substantial increase in capacity between the 1950's and the 1960's was due to insecticide use.

crease the Cocoa Marketing Board's handling cost to the extent that output would expand, with the result that the residual for the government would be reduced.[87]

In the circumstances, beyond a general statement that an optimum tariff should be employed, the appropriate first-best set of policies for cocoa is not obvious. And because it is seldom possible to distinguish which distortions must be taken as given, even a second-best optimum may not be possible to specify. We have no unique contribution to make in this regard. Rather, we are interested in the extent, if any, to which the system of the 1960's altered the relative attractiveness of cocoa exporting *vis-à-vis* other activities in the economy.

A simple summary indicator of the relative attractiveness of cocoa exporting is the price-level-deflated effective exchange rate (Table II-8). From the mid-1950's through 1964 a relatively constant level was maintained, with fluctuations around a rate somewhere above N₵ 0.50 per dollar. However, a distinct break occurred in 1965. The domestic inflation permitted by the exchange control system resulted in a drastic drop in the price-level-deflated effective exchange rate facing cocoa exports. Some recovery followed in 1966 and early 1967, but the level was nevertheless substantially below the average of previous years. The emergence of domestic inflation, together with the low nominal fixed producer prices, thus led to a relative decline in the attractiveness of growing cocoa for export.

This pattern, given the approximately unitary long-run supply elasticity cited above, resulted in a withdrawal of resources from the cocoa sector. In 1964/65 new plantings ceased, and have apparently not been resumed since. For the long run this suggests a potentially serious stagnation of cocoa export earnings.

(c) Imports

On the import side a limited policy response to rising relative domestic prices was attempted. In an effort to mop up the excess demand spilling over on imports during the first half of the 1960's, higher taxes on imports were imposed, with an increase in the effective exchange rates facing imports of almost 33 percent by 1966 over 1960 (see Table II-1). This, however, was not nearly enough to keep the relative price of imports in line with the domestic

87. For example, if the demand elasticity were −1.4 and the producer supply elasticity were 1.0, a 10 percent increase in producer price would result in 10 percent additional output, a fall in the export price of about 7 percent, and a rise in export receipts by about 2.3 percent. For the absolute size of the residual between export receipts and producer payments to increase (rather than decrease) in these circumstances, the producers' share would have to be less than 2.3 percent/21 percent = 11 percent of export receipts.

price level: the domestic component of the GDP deflator rose by about 95 percent in the same period (Table II-7).

Instead, the government assumed that licencing could be used to contain imports. Yet the licencing system was far from adequate to cope with the pressure on imports. While the pressure was initially vented on domestic prices, this in turn shifted the demand for imports outward, resulting in an unsatisfied demand for imports at the tariff inclusive price which was even greater than the initial excess demand. The result was rising pressure on the licencing system. By 1965 as we noted above (section II-5) the licencing system had almost completely broken down. The reason for this failure of the licencing system goes beyond mere corruption on the part of administrators: the relative price difference had grown so large that major internal forces were clamoring for a relaxation of licencing.[88] Had reduced aggregate demand policies and/or a realistic effective exchange rate facing imports been used to dampen the demand for imports, the licencing system would not have had to bear the pressure which it ultimately proved it could not withstand. Put another way, licencing could be used to limit imports for an extended period only when apparently redundant instruments such as tariffs and reduced aggregate demand are also employed.

Thus, our hypothesis is that the import system worked in a way that the level of aggregate demand in current prices was the major determinant of the level of imports. Licencing may have had some negative effect on imports, but was not the sole determinant. Rather, the import system generally responded to increased aggregate demand by increasing imports in much the same way as before the introduction of licencing. To test this we expressed the relationship in the following linear form:[89]

$$M_t = \alpha + \beta_1 \, \mathrm{GDP}_t + \beta_2 \, \mathrm{DLIC}_t + u_t \tag{II.5}$$

where M = c.i.f. value of imports of goods at current prices, millions of N₵

88. See Tony Killick, "The Purposes and Consequences of Import Controls in Ghana," *op. cit.*

89. Because we are considering total merchandise imports rather than some subset, we chose to use a highly aggregated indicator of demand pressure (GDP in current prices) as an explanatory variable. Real and price components, private and public components, consumption and investment components, are all lumped together in the one explanatory variable. The overall relationship masks changing composition of imports and of GDP. Work by J.L.S. Abbey and C.S. Clark is currently underway at the University of Western Ontario on a macroeconomic model of Ghana which, among other things, will provide disaggregated import functions. Our purpose here is far more limited: to give a descriptive first approximation of how the import system worked.

(Table A-4a), GDP = gross domestic product at current prices, millions of N₵ (Table IV-2), DLIC = 1 for all years licencing enforced (1962, 1963, 1964, 1966) and zero for all other years. Ideally we would want a constant price series for imports. Since such a series is not available for the entire period we are interested in, we have specified the value of imports in current c.i.f. prices on the grounds that there has not been any major variation in the foreign prices of imports facing Ghana.[90]

For the period 1955 through 1966 the ordinary least squares regression yielded:

$$M_t = 114.9 + 0.1205\ \text{GDP}_t - 32.10\ \text{DLIC}_t$$
$$(3.456)\ (3.560) \qquad (-1.287)$$

Observations = 12
$R^2 = 0.605$
D.W. = 1.367

The coefficient for GDP is significant at the 1-percent level, while that of DLIC only at the 15-percent level. The Durbin-Watson test is inconclusive. This result suggests that the system permitted imports to respond significantly to GDP in current prices, and somewhat less precisely to licencing. It is important to note that this estimated relationship does not represent an import demand function, but rather is simply a description of the behavior of the import system which operated prior to 1967.

To sum up, the strategic choice made in 1961 to opt for direct controls of both exports and imports resulted in the venting of aggregate demand pressure on domestic prices. This, in the absence of compensatory policies, led to an immediate deterioration of non-cocoa exports and eventually to a cessation of new cocoa plantings. At the same time the system of direct controls proved inadequate to contain the pressure of domestic demand, which without a sufficiently high effective exchange rate facing imports resulted in a continuing high level of imports.

Aggregate demand and hence, in a world of controls, relative prices in the domestic economy proved to be powerful forces affecting the performance of exports and the level of imports. Neglect of these forces to concentrate on symptomatic treatment by attempting direct control resulted in unsustainable balance-of-payments deficits. By the end of 1966 it was clear that something drastic had to be done, and done soon.

90. Note that the exchange rate remained unchanged during the period considered in the regression.