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Progress and Challenges of Financial Reforms in Ghana

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Abstract

This paper purports to review the theoretical and the empirical literature on the progress and challenges of financial reform policies implemented in Ghana since 1982. The literature reviewed show that in Ghana, the results of the financial reform policies have had positive impact. However, in some sectors, the reform policies have led to other challenges not envisaged at the onset of the reforms. Thus, policy makers should put in place an emergency plan to resolve any possible challenges that might occur, as a consequence of the implementation of financial reform policies in other countries.

Keywords

Ghana; Financial reforms; Theoretical

Introduction

According to Schumpeter et al. [1], the role of financial sector is instrumental to economic development. Many economists have been debating on the impacts of the financial sector on economic growth. Most of the debates have been focused on the question whether the financial sector is the source of economic growth or financial sector developments come about as a result of economic development or growth. In other words, does economic development cause the development of the financial sector? Robinson et al. [2] argues that financial intermediation does not cause economic development but rather it is a consequent of industrialisation. This view dominated the debate until the middle of the 1960s. Gerschenkron et al. and Goldsmith et al. [3,4] and others, all highlighted the important role that the financial sector can play in the process of economic development. In the 1970s, the discussion concentrated on the hypothesis on financial repression, a policy implemented by government authorities in many developing countries to generate growth and raise revenue by setting artificially low interest rates and inflationary monetary policies.

Progress and challenges of financial reforms in Ghana

In Ghana, financial reforms polices started in 1982 under the Economic Recovery Programme (ERP) and it can be concluded from the available outcome that the financial reforms have been successful on the account that it has increased foreign capital flow, it has improved the reserve position of the country, it has stabilised and propelled financial savings and prevented and reversed the falling financial deepening and resource mobilisation [5].

However, the financial reforms in Ghana brought with them a number of other challenges which should have been addressed by policy makers. These include the large interest rate margins, increase in foreign currency deposits, constant depreciation of the domestic currency, drastic increase in imports and reduction of credits to the productive sectors of the economy. It therefore came as no surprise when, in a recent speech, the Governor of the Central Bank of Ghana cautioned against the unacceptable level of the spread which he put at 15% point. This has risen to its highest of about 21.2% recently. Another negative effect of the financial reforms, which the policy makers should address as soon as possible, is the problem of high lending rates which has discouraged investment in the productive sectors like agriculture where about 50% of the Ghanaian population are still engaged.

The case of Ghana, however, supports the financial reforms hypothesis. This is because, financial savings which started decreasing before the financial reforms were stabilised for two years after the policy, then in the third year started to increase steadily and have been at post reform level till date. Financial deepening as measured by the ratio of money and quasi money (M2) to gross domestic product (GDP) and which was 13% before the financial reforms stood at 29.0% post reforms. Economic growth has been steady at an average of 4.8% after the financial reforms compared to 1.0% pre the policy. Investments which were about 14.0% at the beginning of the reforms stands at 33.0% of GDP post reforms and savings which was 5.0% also stands at 10.0% post reforms. The one negative impact is that, the efficiency of credit allocation in the economy has deteriorated. However, one cannot attribute this negative outcome to the financial reforms policy alone. The other side of the coin is the interrelated bottlenecks, rigidity and under-development of the Ghanaian financial system as a whole Owusu et al. [5]. An empirical analysis using econometrical method, autoregressive distributed lag or the bounds testing approach was performed by Owusu et al. and Odhiambo et al. [5,6].

The reforms in Ghana have highlighted some of the weaknesses of the financial reforms hypothesis. Alongside financial reforms, particular attention should also be given to institutional development and given the peculiarity of the country. For Ghana, with a high degree of openness (50.0% pre and 81.6% post reforms) As measured by the ratio of export and import to GDP, successful financial reforms are expected to effect a significant shift of resources from foreign currency deposits to domestic currency deposits and from the component of the leakage to the formal financial sector because of increase in the deposits rates but instead there was a strong condition for the phenomenon of currency substitution. Currency substitution, as measured by the amount of foreign currency deposits in the domestic banks stood at about 17.8% of total deposits pre reform periods. This increased to an average of about 28.1% post the reforms. Furthermore, using stock market capitalisation as a measure of capital accounts development, it can be shown that, the relationship between capital account reforms and economic growth is not clear [7].

One positive aspect of the capital account reforms policy is the relatively large inflow of capital into the country. But while the sterilisation of the inflow capital is deemed necessary for ensuring the

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sustainability of capital, the cost of sterilisation and non-intervention in the foreign exchange market is feared to have jeopardised the fiscal programmes, and the high interest rate is feared to discourage investment in the real sector. This will increase the pressure on the exchange rates and lead to capital flight (if the domestic situation is perceived to be unstable) out of the country. This could be mitigated or minimised through the stabilisation of the exchange rate and the development of capital markets to introduce alternative financial products such as stocks, corporate bonds, treasury bills and government securities. At present the treasury bills and government security markets are reasonably well developed in Ghana but there is still the need to develop corporate bonds and other private sector securities market. These products will provide good alternatives to the holding of foreign currencies and allow them to diversify their investments and minimise the risk of holding assets dominated in the domestic currency in times of unstable economic situations. The main challenges facing the capital market must, however, be tackled if the capital markets are to play any major role in Ghana's development.

Conclusion

The theory of financial reforms holds, as its ultimate objective, the full liberalisation of all interest rates in the domestic financial markets and the reforms of the capital markets. The hypothesis holds that, it is only financial reforms that will accelerate the growth of the real economy. Whereas the critics argue that this will lead to stagnation and inflation and therefore the strategy for accelerated growth should be through increased capacity utilisation. For Ghana, the outcomes of the financial sector reforms are relatively successful.

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