

# GHANA

## Strategy Support Program



### Economic Transformation in Africa: Where Will the Path Lead?

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DISCUSSION NOTE # 002

## INTRODUCTION

This brief focuses on growth patterns, structural change and agglomeration to assess the progress of economic transformation in Ghana. While Ghana has been seen as a successful story in Africa because of its sustainable growth performance and impressive poverty reduction over the last two decades, Ghana's economy has actually exhibited less transformation than might be expected for a country that has recently achieved low-middle income status.

Unlike many successfully transformed countries in Asia and Latin America, agricultural share in the economy has declined slowly in Ghana and reduced share of agriculture in the economy has been filled by services instead of manufacturing. Growth in the manufacturing sector is not impressive and its share in the economy has stagnated and even declined. Moreover, the urbanization process in Ghana is much more rapid than in Asian and Latin American countries during their early stage of transformation. The emergence of "consumption cities" that are full of service-oriented economic activities indicates a growth pattern that is consumption-driven and has created upward pressure on the exchange rate and weakened production linkages. These trends have made it difficult for the private sector to lead manufacturing growth.

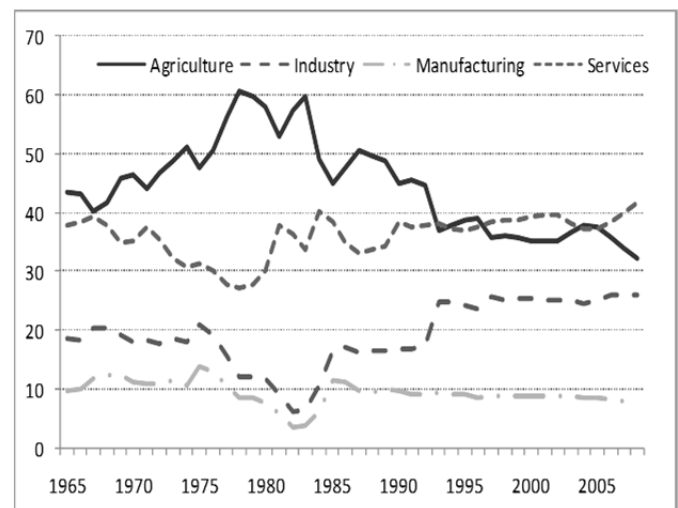
## MAIN FEATURES OF THE ECONOMY

Ghana's growth performance has been impressive when compared with its own performance before the mid-1980s, and when compared globally. Between 1985 and 2010, the annual GDP per capita grew by 2–3 percent in most years. Growth started to accelerate after 2004 with annual GDP growth rate above 6 percent between 2005 and 2010. Among all developed and developing countries, only a few have achieved consistent growth over such a long period. According to Ghana Living Standard Surveys (GLSS) 3 and 5, growth has been accompanied by a reduction in poverty, with poverty incidence falling from 51.7 percent in 1991/92 to 28.5 percent in 2005/06. If Ghana continues along this trajectory, it is likely to achieve the MDG 1 of halving its

poverty rate in 1990 before the target year of 2015, outperforming many other African countries.

Since the mid-1980s, consistent growth across sectors suggests that structural change has been modest with an expanding service sector and a diminishing agriculture sector. The share of agriculture in GDP has fallen, but remains an important economic of service sector to GDP was relatively stable during the entire post-colonial period and its importance has risen in recent years to become the largest economic sector, accounting for 50 percent of GDP. Share of manufacture has fallen to below 9 percent of GDP (Figure 1). Export structure remains concentrated in cocoa and gold. Natural resource dependency is further in danger of being enhanced with the discovery of oil.

FIGURE 1—SECTOR SHARE OF GDP, 1965-2008



## AGRICULTURE

Agriculture is transforming slowly, led primarily by development of nontraditional exports. Productivity has changed only marginally in traditional agriculture. Although the agriculture sector in Ghana has grown at 5 percent per year over the past decade, much of this growth has been driven by an expansion of land area (primarily led by expansion in cocoa) rather than improved yields, and the contribution from productivity increase is rather

modest. As a result, the agricultural sector is not able to compete with imports of products traditionally produced in the country and, excluding cocoa, Ghana has recently become a net agricultural importer of primary foods and agro-processing products. The value of net agricultural imports reached nearly US\$1 billion in 2008 and almost one third of foreign exchange earned by exporting cocoa was used to pay for imported foods and other agricultural products. The increasing demand for meat, rice and processed foods, a result of growing urbanization and a growing middle class, is increasingly met by imports. Although there has been some labor exit from the sector, 55 percent of employment is in the agricultural sector. area (primarily led by expansion in cocoa) rather than improved yields, and the contribution from productivity increase is rather modest. As a result, the agricultural sector is not able to compete with imports of products traditionally produced in the country and, excluding cocoa, Ghana has recently become a net agricultural importer of primary foods and agro-processing products. The value of net agricultural imports reached nearly US\$1 billion in 2008 and almost one third of foreign exchange earned by exporting cocoa was used to pay for imported foods and other agricultural products. The increasing demand for meat, rice and processed foods, a result of growing urbanization and a growing middle class, is increasingly met by imports. Although there has been some labor exit from the sector, 55 percent of employment is in the agricultural sector.

## INDUSTRY

Measured by growth and structural change within industry, Ghana's industry is the least transformed sector in the economy, with the relative contributions of the industrial sub-sectors little changed between 1993 and 2005. For the past 15 years, the share of industry in Ghana's overall GDP has remained virtually constant at around 25 percent. Share of employment in industry is about 15 percent. The most dynamic and largest sub-sector in the industrial sector is construction, which is generally non-traded and has much weaker linkages with the rest of the economy than manufacturing. Construction growth has primarily been driven by an urban housing boom and infrastructural developments.

Manufacturing in Ghana is dominated by agriculture-related activities, including food and wood processing and textiles, which accounted for more than 60 percent of manufacturing GDP in 2007. The average annual growth rate in manufacturing was only 3.2 percent between 1994 and 2010, the lowest among Ghana's industrial subsectors. Most manufacturing firms are small and informal, and analysis has found that small enterprises die early and die small, while large firms in Ghana are born big. Most FDI in Ghana has gone into mining (around 70 percent over the past 15 years), resource-based manufacturing, telecommunications, and

banking, suggesting that most FDI is resource- and market-seeking rather than efficiency-seeking.

## SERVICES

Ghana has a large and growing services sector, which encompasses many parts of the public sector and a wide range of private activities (trade, transport, restaurants, and hotels) that mainly serve demands arising from resource-based extractive industries, remittances, and development assistance. The sector has become the largest in Ghana's economy in recent years, reaching 50 percent of GDP in 2006. The sector grew most rapidly between 1994 and 2010 with an annual growth rate of 5.9 percent, as against 5 percent for industry and 4.4 percent for agriculture. The most rapidly growing subsectors of services in Ghana are non-traded and are consumption-related. Moreover, more than one-third of the services are public and government-related such as administration, health and education.

Up until the mid-1990s the wholesale, retail, restaurant and hotel subsectors were the major contributors to the services sector's GDP growth, after which government services became the largest subsector. Ghana's recent growth has increasingly concentrated in the non-tradable part of the economy, including non-tradable industrial sectors such as utility and construction, a warning symptom of the Dutch disease and real exchange appreciation. Only a small proportion of the service sector is export-related, but even here it is still consumption-related such as luxury hotels and restaurants that provide services to foreigners.

Ghana appears to be in a phase of "informalization". The share of the informal sector in total employment is estimated at 80 percent and is characterized by relatively high labor market flexibility and high employment insecurity, as is common in many sub-Saharan African countries. Ghana's share of services in employment has grown to more than 30 percent and is likely higher if informal activities are included.

## LINKAGES BETWEEN THE SECTORS

The analysis of the paper demonstrates that manufacturing and its subcomponent, agro-processing, have the strongest productive linkages, although not necessarily with domestic production. Ghana's agricultural sector, on the other hand, has the weakest backward linkages compared with the rest of the economy, particularly the industrial sector. This is not uncommon among African countries because agricultural production uses little intermediate input, which neither stimulates demand for industrial goods nor investments in downstream activities. The forward linkages of agriculture to other economic sectors are stronger with 13% of agricultural products used as intermediate inputs for other sectors. Cocoa's consumption linkages have driven urbanization in the cocoa belt, resulting in a rise of *consumption cities* driven by

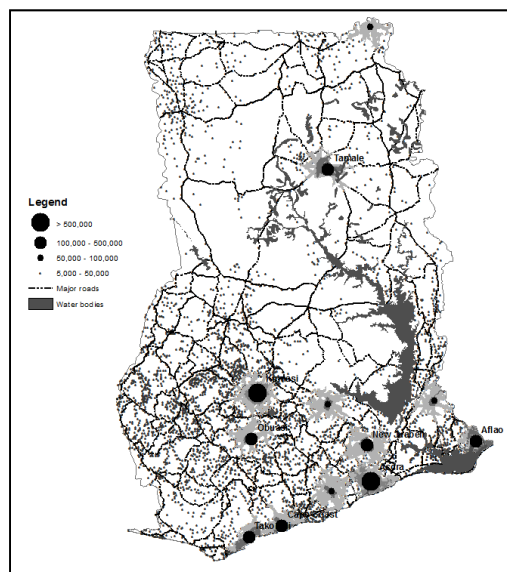
farmers, traders, and providers of other services, and based on agriculture and non-tradable services. These cities have less manufacturing and are less economically diversified than *production cities* and may not hold as much potential for sustained and accelerated growth.

Ghana's rural households have diversified their livelihoods through rural to urban migration and through increasing participation in the rural non-farm economy. Most internal migration occurs from the rural to the urban south, driven primarily by "push" factors, with migrants from the poorer north faring poorly economically compared with those migrating from the rural south.

## URBAN AGGLOMERATION

We now examine whether economic activities are related to agglomeration by looking at sources of household nonfarm incomes, using GLSS4 (1998/99) and GLSS 5 (2005/06). Districts are categorized into three agglomeration categories—large urban, medium urban, and small town. Within these categories, urban and rural households are considered. Figure 1 shows the location of the agglomeration categories and their periphery areas. About 47 percent of Ghana's population lives in agglomerated urban areas with more than 50 percent of the urban population living in the two largest cities, Accra and Kumasi (each has population of over 1.5 million). Urban areas have peripheries three times the size of the cities themselves that are well-connected to their urban centers. Peripheries have population densities lower than in urban areas, but much higher than in rural areas. These areas have potential for further urban expansion or developing urban-oriented high-value agriculture (Figure 2).

**FIGURE 2: URBAN AGGLOMERATIONS AND THEIR PERIPHERY AREAS**



Source: Authors' calculation using agglomeration index method. The population data are from 2002 Landscan developed by Oak Ridge National Laboratory and the road data were provided by a research partner in Ghana.

Notes: The largest dots correspond to largest urban agglomerations, Accra and Kumasi, with populations of more than 500,000. The second largest agglomerations, with population between 100,000 to 500,000, include Takoradi, Cape Coast, and Aflao in the coastal areas; New Juaben and Obuasi in the south; and Tamale in the north. The gray shading surrounding the dots represents the urban periphery area.

Urbanization and urban agglomerations have created more nonfarm income opportunities and household income structure has changed with urbanization. 56 percent of households reported nonagricultural income in 2005/06, up from 50 percent in 1989/99. The share of households earning nonagricultural income increases with the size of agglomeration. At the national level, agricultural income was about one third of total household income in 1998/99, and the proportion fell to 19 percent in 2005/06.

The impact of urbanization is concentrated in large urban agglomerations and the role of medium agglomerations in creating nonagricultural opportunities is limited. Rural households living in the periphery areas of medium urban centers had more opportunities to participate in nonagricultural activities in 1998/99 than in the other locations. However, such advantage for medium urban disappeared in 2005/06, as the difference in the percentage of rural households that reported nonagricultural income became insignificant between medium urban and small town. This is most likely because mining areas are part of medium urban, where many rural households living in the peripheries earned income from mining. Such opportunities declined in recent years.

On the other hand, many more rural households living in the large urban peripheries reported nonagricultural income in the recent survey (48 percent, 2005/06) than in the early one (33 percent, 1998/99). By location, it is surprising that households living in small towns experience the most rapid decline in their share of agricultural income. In 1998/99, 57 percent of their total income came from agriculture, but by 2005/06 it was reduced to 30 percent. Agriculture is no longer the main income source for Ghanaian rural households. It is not surprising to see that the most rapid changes in rural households' income structure are observed in the large urban periphery areas, where agricultural income provided only a quarter of their total income to the rural households in the recent survey, falling from 50 percent in 1998/99.

Agriculture's declining share of total income was replaced by two types of nonagricultural incomes: self-employment and wage income (Table 1). The primary increase was income from self-employment, whilst the share of wage income increased modestly. The share of "other income", predominantly transfers, changed little between the two surveys. Nonfarm self-employment activities are the dominant source of nonagricultural income regardless

of agglomeration size. However, most nonagricultural activities are informal, and informal income grew more rapidly in small towns. Moreover, nonagricultural opportunities are dominated by services both in rural and urban areas and for formal and informal activities. For wage earners, service income is mainly government-related salaries; for self-employees, commerce accounts for 90% of service income.

Agglomeration and its economic implications in Ghana have been more related to clustering of people, creating potential consumption markets for goods and services rather than a clustering of manufacturing, and offering benefits for production. Firm level studies show that agglomeration can create economies of scale and one might expect a proliferation of formal firms in agglomerations.

However, the Ghana data at the household level suggest that most nonagricultural income comes from informal sources, which are captured as nonfarm self-employment income. Wage income accounted for 22 percent of total income for all households in 1998/99, and this share increased modestly to 25 percent in 2005/06. On the other hand, the share of self-employment income in total income increased from 36 percent in 1998/99 to 49 percent in 2005/06. Moreover, this trend is consistently seen in all three locations for both rural and urban households. For households with informal income, services still dominate their nonagricultural income. Manufacturing share in total nonagricultural income is much higher in the locations outside large urban agglomerations. Formal manufacturing is concentrated in large agglomerations while informal manufacturing such as *gari* and *kenke* making is somewhat higher in small and medium agglomerations. Self-employed income from service sector is largely from commerce, 90 percent in total.

## CONCLUSIONS

Ghana has not taken the same path as the most successfully transformed countries in Asia and Latin America. Ghana's reduced share of agriculture in the economy has been filled by services while manufacturing has stagnated and even declined. Inadequate agricultural transformation may be a reason. A rapidly transforming agricultural sector can help other sectors' transformation through linkages. But Ghana has not experienced the kind of agricultural productivity growth that can drive the development of competitive agro-processing industries.

Ghana is one of the more urbanized countries in Africa, but its urban economic activities are dominated by those that benefit little from economies of scale of agglomeration. Consumption – cities are emerging as a result of cocoa and gold export revenues, remittances from migrants, and foreign aid. As in many resource-rich developing countries, this situation leads to exchange rate appreciation, which further disadvantages the development of tradable sectors other than cocoa and gold in both agriculture and manufacturing.

As a result, economic growth in Ghana has become increasingly consumption-driven and structural change in terms of non-agricultural employment opportunities and household livelihood choices is led by development of services, mostly informal. In Asian countries, transformation was first led by technological change and productivity growth in agriculture. Increased labor productivity in agriculture benefited the expansion of labor-intensive manufacturing, which is the key driver for success in transformation.

Will this be the only path for transformation in Ghana or does Ghana have to find a different path? This is an important development question that deserves more research.

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