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Findings

23106

Africa Region . Number 38 . April 1995

Findings reports on ongoing operational, economic and sector work carried out by the World Bank and its member governments in the Africa Region. It is published periodically by the Africa Technical Department on behalf of the Region.

Ghana: Bringing Savers and Investors Together

Following a prolonged economic downturn, the Government of Ghana embarked on a new path by launching the Economic Recovery Program (ERP) in 1983. Ten years later, Ghana had made significant achievements. Real Gross Domestic Product (GDP)growth averaged 5 percent a year and the economy had been substantially liberalized. On the surface, Ghana appeared to have a bright future.

Yet, private savings and private investment had remained far below levels considered necessary for self-sustaining long-term growth. According to official statistics, the savings rate in Ghana remained well below levels recorded in other countries with similar per capita income. Similarly, private investment was low enough to raise questions about the sustainability of Ghana's growth performance. Furthermore, the financial system still had little depth-which is often an indicator for a country's long-term growth potential-despite 10 years of strong economic growth, and was not playing its role in ensuring the smooth flow of financial resources between savers and investors.

To address these concerns, the government asked the World Bank to assist in a review of the financial sector with the objective of finding ways to improve the flow of financial resources in the economy. The ensuing joint report , *Ghana Financial Sector Review - Bringing Savers and Investors Together*, lays out achievements, identifies bottlenecks, and proposes measures to enhance the sector's ability to intermediate and fully contribute to economic growth.

Savings and Investment in Ghana

Ghana has never been able to record high savings rates. In fact, gross national savings never rose above 15 percent of GDP. After falling to under 5 percent in 1983, the savings rate recovered but remained below 10 percent. This level compares quite unfavorably with East Asian countries where savings rates of 30 percent are common. Similarly, recorded investment rates are far below levels required to push Ghana into an accelerated growth mode.

However, according to surveys, private savings in Ghana are probably higher than the official data suggest. Savers hesitate to keep their assets in financial form. Instead they prefer to hold them in less risky forms that provide a very low (and perhaps even negative) rate of return. This would suggest that the resources to finance productive investments may already exist in Ghana. Yet, this also means there is no guarantee that the most productive investments are undertaken. It is important to understand why individuals are reluctant to participate in formal financial markets. It is equally important to understand the cost that low intermediation poses to the economy in terms of lost economic growth. There is a tremendous capacity for improving growth prospects by encouraging individuals to hold their savings in financial forms.

The most prominent factors contributing to the low level of financial intermediation are:

- low confidence in the formal financial system;
- macroeconomic instability; and
- lack of competition among financial institutions.

The measures proposed in the report, which have the full support of the government , will go a long way towards addressing these issues and achieving self-sustained accelerated growth in Ghana.

Restoring Confidence

Restoring full confidence in the financial sector may be the most difficult obstacle to overcome. To understand the Ghanaian's mistrust of formal financial institutions, one has to go back a number of years. Prior to the ERP, the Ghanaian financial system was highly controlled. The bulk of credit went to the government or to state-owned enterprises and real interest rates on deposits were negative.

In 1982, the government demonetized the 50 Cedi note; froze bank deposits in excess of 50,000 Cedis pending investigation for tax liability; restricted bank loans for the financing of trade inventories; and required that business transactions in excess of 1,000 Cedis be conducted by check (1 US$ then equalled 275 Cedi). Whatever the government's intentions had been, these restrictions greatly undermined savers' confidence. Although all financial restrictions that had been imposed prior to the ERP were subsequently lifted, public confidence was slow to recover. The Ghanaians' dislike for dealing with formal financial institutions has been compounded in recent years by the unstable macroeconomic environment. Many of the policy recommendations outlined in the report will serve to strengthen confidence in the financial sector.

Maintaining Macroeconomic Stability

Restoring a viable and sustainable macroeconomic environment is a precondition for strengthening the growth of the financial system. Eliminating fiscal deficits-and their financing through the central bank-and bringing down inflation to international levels will do more to restore confidence and enhance intermediation than any other policy change.

Fiscal Policy

Fiscal policy determines the allocation of financial resources between the public and private sector.

From 1988 through 1991, the private sector received about half of total credit. With the increase in financing needs in 1992, even this share fell. In addition, Ghana's ratio of private credit to GDP, 5.3 percent in 1993, has been extraordinarily low, even by African standards. Open market operations, which should only be used to smooth out fluctuations in the money supply, have been used to mobilize private savings to finance the fiscal deficit. These deficits, and the printing of money, have led to high inflation and high interest rates. Moreover, questions about the sustainability of fiscal deficits have increased uncertainty about future policies and have, thus, had a significant impact on the level of investment. Achieving a fiscal surplus so that more domestic financial resources can be funneled to the private sector will be a critical ingredient in an accelerated growth strategy.

Monetary Policy

Monetary policy aims to achieve two important objectives: managing liquidity to ensure the availability of funds, and promoting steady economic growth without creating inflation. Monetary policy is also important in transmitting signals about credit conditions throughout the financial system and in developing efficient and fluid capital markets. All these functions contribute to greater mobilization and the more efficient allocation of financial resources.

The Bank of Ghana has two principal instruments that it uses to carry out monetary policy: selling and buying government securities through an auction and setting reserve requirements for banking institutions. Since early 1992, the government has used auctions to carry out its monetary policy. In part, these auctions have also been used to place government debt instruments that were issued to finance the fiscal deficit. In the coming years, it will be necessary for the government to run fiscal surpluses to accommodate private sector credit expansion. As this happens, newly issued government securities will not fully replace maturing ones.

Concerns also arise over the effects of Ghana's high reserve requirements-currently 52 percent of banks' deposit base-on the banking system. Developing a loan portfolio requires the development of certain skills and the collection of information on potential borrowers. There may be a threshold of loan activity beyond which the returns do not merit the costs. Current reserve requirements may leave insufficient capital to meet this threshold. Furthermore, since banks are earning high interest on their reserves, the return from developing the loan portfolio may simply not be worth the effort.

Together with sound fiscal management, containing money supply growth will be essential to restore price stability. A sharp expansion of the money supply caused inflation to jump from an average of 10 percent for 1992 to over 24 percent in 1993. To eliminate price uncertainty, the government must make every effort to restore price stability through restrictive monetary policies.

Strengthening Financial Institutions

The basic institutional foundations for enhanced financial intermediation are already present in Ghana. Its bank financial institutions include the Central bank-the Bank of Ghana-9 commercial banks, 3 merchant banks, and over 100 rural unit banks. Non-bank financial institutions include a stock exchange, 21 insurance companies, the Social Security and National Insurance Trust, 2 discount houses, the Home Finance Company, numerous building societies, a venture capital company, a unit trust, and a leasing company. Informal financial arrangements include "susu" collectors, who engage in mobilizing short-term savings, rotating credit groups, and traders and money lenders.

The Banking Sector

Banks are at the heart of Ghana's formal financial system. Following several years of reform, the sector now enjoys a sound regulatory framework and is free of major distortions such as interest rate controls and sectoral credit allocations. However, dominated by state-owned institutions, the sector shows few signs of competition. The 7 state-owned banks, of which the Ghana Commercial Bank is by far the largest, account for roughly two- thirds of the sector's assets. Furthermore, there is little genuine intermediation between savers and investors. Demand deposits are the main source of funds for banks, but loans and advances account for a relatively small portion of their assets. High reserve requirements have prevented banks from building up their loan books, while hefty returns paid on government securities have afforded bankers an easy life.

To revive confidence in the banking system and send a strong signal favoring private participation in the financial sector, the government must proceed quickly with the divestiture of state-owned banks. The government's interim target of reducing public sector ownership to a minority position of no more than 40 percent in each wholly -owned bank should be pursued vigorously. The first phase calls for divestiture of the Ghana Commercial Bank and the Social Security Bank. The second phase will cover the remaining state-owned banks.

Non-bank Financial Institutions

Non-bank financial institutions have yet to emerge as significant players in the Ghanaian financial system. Macroeconomic uncertainty, pervasive state ownership, and-until recently-the absence of defining legislation and adequate supervision arrangements have hindered the development of these institutions. The Social Security and National Insurance Trust (SSNIT), which collects mandatory contributions from employers and employees, accounts for over half of all pension fund assets in the economy. Similarly, the State Insurance Corporation (SIC) has a monopoly on all government insurance needs and accounts for over 60 percent of all assets in the insurance industry.

But there are signs of life. Although still in the early stages of development, leasing companies, building societies, and savings and loan associations have been innovative in serving savers and borrowers. While the stock exchange has only 17 listed companies and low trading volumes, recent success in placing Ashanti Goldfields Company shares has sparked new interest. With the emergence of the Home Finance Company, housing finance also shows potential for rapid growth, and the prospects for establishing primary and secondary mortgage markets are promising.

To allow the private sector to compete effectively, the government needs to take steps to remove the monopoly position of the major state-owned financial institutions. However, some mandatory contributions to SSNIT should remain as one element in a multi-pillar system, with the explicit objective of alleviating poverty in old age. To create a level playing field in the insurance industry, SIC's monopoly on government insurance needs to be removed. Even if no other action is taken, this in itself is likely to boost activities of private insurance firms and generate competition, which would lead to greater rate competition, product innovation, and operating efficiency.

Rural Institutions

Rural financial markets in Ghana consist of formal institutions, such as branches of commercial banks and rural banks, and informal institutions, such as susu collectors. Both can play an important role in intermediating between savers and investors. Thus far, however, Ghana's rural financial markets have not been able to provide people in the countryside with adequate savings opportunities or access to credit-particularly in the agricultural sector.

Ghana's informal financial sector is large. It is estimated that 45 percent of all private sector financial savings are initially mobilized through informal channels. Still, its capacity to intermediate between savers and investors is limited, in part by people's savings behavior, and in part by the absence of strong links with the formal sector. There may be considerable opportunity for profitable contacts between the informal and the formal sectors. For example, savings generated by susu collectors can be deposited at formal institutions, and traders may gain access to formal credit through the simplified use of collateral. The informal sector's capability to mobilize savings and its information base for lending are assets. Formal institutions, may, under pressure of increased competition, wish to harness these capacities. However, given the uneasiness with which formal institutions view informal financial operators, it is important that the government clearly state its support for the informal sector. Informal operators should be encouraged to seek contacts with formal institutions and possibly formalize their own standing.

Realizing the Benefits

Given the relatively small share of total savings that now passes through the financial system, the scope for enhanced intermediation and faster economic growth is large. Conservatively estimated, if 16 percent of existing nonfinancial savings were brought into the system, the increase in real GDP growth would be in the order of 1 percentage point. With a faster uptake, even larger gains could be achieved. The simultaneous deepening of the financial system has the potential to raise Ghana's long-term economic growth. Market growth of this magnitude would also accommodate the entry of new bank and non-bank financial institutions. With government ownership phased out, new entrants would help foster the competition that is essential to achieve enhanced financial intermediation and sustain long-term economic growth.

Hans-Martin Boehmer, Deborah Wetzel and Arvind Gupta. 1994. ***Ghana Financial Sector Review : Bringing Savers and Investors Together****. Report No. 13423 - GH. West Central Africa Department. Washington, D.C. : World Bank.*

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