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The Effects of the Global Economic and Financial Crisis on the Ghanaian Economy and Labour Market



**Working Paper [No.2009/01]
November, 2009**



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Sponsored by
Trades Union Solidarity Centre of Finland

**Kwabena Nyarko Otoo
Prince Asafu-Adjaye**

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ISBN 978-9988-0-9905-3

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A publication of the Labour Research and Policy Institute with support from the Trade Union Solidarity Centre of Finland (SASK)

Printed by **O'Mens Graphix**
Tel: +233-302-238098 E-mail: omens02@yahoo.com

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ACKNOWLEDGEMENT

The authors would like to express their sincere gratitude to the Trade Union Solidarity Centre of Finland (SASK) for sponsoring this working paper. We are equally grateful to the Ghana Trades Union Congress (TUC) for the support it has extended to the Institute not only in the preparation of this working paper, but more fundamentally, its core support to the work of the Institute. We are particularly grateful to Bro. Kofi Asamoah, Secretary-General of the Ghana TUC for his keen interest in and support for the work of the Institute as well as Dr. Anthony Yaw Baah, Deputy Secretary-General of the Ghana TUC for his technical support in the preparation of this working paper. We are equally grateful to our colleague, Clara Osei-Boateng for her useful comments in the preparation of this paper.

LIST OF ABBREVIATIONS

ARM	Adjustable Rate Mortgages
BoG	Bank of Ghana
EPZ	Export Processing Zones
EU	European Union
FDI	Foreign Direct Investment
GCC	Great Credit Crunch
GDP	Gross Domestic Product
GIPC	Ghana Investment Promotion Centre
GSE	Ghana Stock Exchange
ILO	International Labour Organization
IMF	International Monetary Fund
ISSER	Institute of Statistical, Social and Economic Research
NYSE	New York Stock Exchange
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
SAP	Structural Adjustment Programme
TARP	Troubled Asset Relief Programme
TUC	Ghana Trades Union Congress
TWU	Timber and Wood Workers' Union
US	United States

SECTION 1

INTRODUCTION AND BACKGROUND

1. Introduction

In October 2008, the world economy was officially recognised as being in a recession – the great credit crunch – the magnitude of which is only comparable to the great depression of the 1930s. Major stock markets around the globe collapsed, currencies fell in value and inter-bank lending dried-up overnight. The financial and economic systemic crises that have become recurring feature of neo-liberal capitalism once again emerged, this time on a global scale as it was in the 1930s.

The crisis which began in the highly leveraged United States housing mortgage system quickly spread to the financial/banking sector and then finally to the real sector of not only the US economy but more importantly the global economy. The tipping point was the collapse of the 158-year old Wall Street investment bank, Lehman Brothers, on September 15, 2008. The financial and economic crises were preceded by the food and energy crises which began in 2007 and were intensified throughout 2008.

The current global crisis is distinct in several respects. First, it is multifaceted in the sense that while it began in the US housing market, it has spread almost instantaneously to nearly all aspects of the global economy. Part of the problem is that the capitalist system of global finance, production and distribution ensures that all aspects of the global economy are 'tightly coupled'. This means that failures in any part of the system quickly spread to other parts of the system.

Secondly, the current crisis is the first true global crisis that has occurred at the same time as a simmering global ecological crisis. Thirdly, and following from the above, the options for recovery that were available in the previous episodes of economic crisis are no longer available in the current crisis. And finally, the current crisis has huge geo-political implications for global governance with the possibility of shift in global balance of power.

The current global financial and economic meltdown clearly illustrates the fact that systemic crisis has become cyclical feature of the financial system that underpins neo-liberal capitalism. Crisis of this nature now occurs roughly every decade. On July 2, 1997 the near collapse and subsequent floatation of Thailand's currency (baht), tipped the East Asian sub-region into its worse financial crisis. The crisis was again not confined to that region as it quickly spread to other parts of the world.

A decade earlier, on October 19, 1987 the New York Stock Exchange (NYSE) crashed as stock prices dropped faster and larger than it had occurred in the 1929 stock market crash which pushed the world into the Great Depression. On that day, average stock prices declined by more than 23 percentage points leading to an estimated loss of US\$500 billion.

The responses to the current crisis have been mixed. In North America, Europe, Japan and China, governments have poured out trillions in loans, equity infusions and bailouts of troubled corporate entities. In an unprecedented move, the US Federal Reserve Bank gave out US\$1.1 trillion in new lending in a period of six weeks. European governments focused more on equity infusions directly into troubled banks. China followed with its own brand of cash injections pumping over half trillion dollars to prop up domestic demand.

In the developing world, particularly in Africa, the responses have shifted from denials, and perceived robustness of the domestic economy to withstand the storm generated by the crisis to acknowledgement that their economies are after all not immuned to the crisis. The responses in much of Africa has been a return to the IMF which despite the rhetoric of the past years continues to prescribe pro-cyclical economic policies that proved disastrous for most African economies

under the Structural Adjustment Programme (SAP).

The flood of new cash pumped into the world economy by central banks in loans, bailouts and direct equity infusions is estimated at 11 trillion dollars. In the US alone, a huge amount of US\$5 trillion of mortgage debt has been taken over by the state. The US government is today the largest car-maker in the world having taken over almost the entire auto industry. Such high levels of state interventions are demonstrations of limits of markets which are so central to the neo-liberal economic doctrine.

In this paper, we contribute to the understanding and appreciation of the complex finance that pushed the world into what is perhaps the most costly financial and economic crisis in history. In the section after this introduction, we look at the origins of the crisis and its transmission mechanisms. Section 3, is devoted to analysis of how the crisis spread to the rest of the world. Section 4 analyses the effects of the crisis on the global economy while section 5 discusses in detail the effects of the crisis on Ghana. In section 6, we discuss the responses to the crisis and conclude the paper in section 7.

SECTION 2

THE ORIGINS OF THE CRISIS

The immediate sign of global economic ill-health was felt in the US financial markets. It has therefore become trite knowledge that the current global economic crisis which became obvious in October 2008 was sparked by bank failures in the US, the world's biggest economy. However, the crisis has its roots in the US housing market which in the closing years of the 20th century and the first few years of the 21st century became the launching pad for economic prosperity in the US. The financial sector was over-exposed to highly unregulated and sometimes 'dubious' transactions in the housing market.

In the late 1990s and early 2000s, the US experienced a housing boom unparalleled in its history. Spurred on by a deliberate government policy to increase house ownership, the US housing market became an instant investment destination. Through mortgage-backed securities, financial institutions and investors around the world invested heavily in the US housing market. The total home equity in the United States, at its peak in 2006 was valued at US\$13 trillion and between 2000 and 2005 the market value of homes grew by an astonishing 50 percent. In the first half of 2005, an estimated half of American GDP growth came from housing-related purchases, and housing-related activities provided more than half of all new private sector jobs since 2001 (Merrill Lynch, 2005).

The housing boom was spurred and supported by a complex array of financial instruments. In the US housing market, the long-term value of a house follows closely the rate of consumer price inflation. Houses are therefore regarded as a reliable source of savings. A 50 percent increase in the price of houses as was experienced between 2000 and 2005, more than overshoot the long-term value of houses and changed the balance of incentives.

Expert analyses have shown that the housing boom of the 2000s defies historical explanations of previous housing booms in the 1970s and 80s. In particular, the 1990s witnessed no major demographic transitions, real median household wage was almost constant and consumer savings were at historically low levels. The boom in the housing market was therefore the creation of the financial market which no longer found profitable outlets in the real economy. This is buttressed by the fact that the housing bubble also occurred in the UK, Australia, and Spain and other rich countries.

The lower interest rates policy regime of both the Clinton and Bush administrations facilitated the increasing financialisation and the subsequent boom and burst of the housing market. The low interest rates pushed the yield (interest rates) on prime mortgages at a historic low level. Banks could not generate the rate of return investors were looking for by focusing on prime mortgages.

At the same time, the financing of big multinational enterprises shifted in the direction of less reliance on banks and more on complex financial instruments including bonds and derivatives. In a bid to maintain their profit levels and meet their expansion plans, banks focused more on home mortgage lending. The ensuing competition was fierce and unbridled. The mortgage market itself became saturated and the ferocious appetite for profit could no longer be met by relying on prime mortgages.

The banks therefore resorted to what has become known as the sub-prime mortgage lending. Subprime mortgages are given to people whose credit ratings under normal circumstances would not have qualified them for mortgage loans. These are borrowers with low credit rating but were allowed to borrow thus increasing their vulnerability to interest rate risks. The banks lent aggressively and recklessly to these financially less secure, poor, minority and migrant households. In the US alone the value of sub-prime mortgages shot up significantly and was estimated at US\$1.3 trillion as of March 2007. Sub-prime lending increased from US\$145 billion in 2001 to US\$625 billion in 2005. More than one-third of the loans were secured at 100 percent of the home value. By the end of 2006, the portfolio of these high-risk sub-prime mortgages accounted for about 40 percent of all mortgages.

The huge sub-prime loans that were on offer were themselves a trap. The initial low interest rates and the absence of collateral including low or no down payments were the baits. Housing credit was indeed made cheap and easy to access for all including those who do not qualify for regular loans. The cheap credit created the biggest, longest and most profitable housing boom in the history of the world. Housing prices rose significantly and rapidly above their long-term values. Then the bubble bursts. What many did not know was that after some few years the low interest rates quickly rose to their long-term levels.

The large number of financially less secured poor households that have received billions of cheap dollars defaulted almost simultaneously. They no longer could meet their repayment obligations. The initial two-year fixed low interest rate period has expired and borrowers are now confronted with higher and variable interest rates – Adjustable Rate Mortgages (ARM). The new monthly repayments doubled or tripled in some cases and were higher than total monthly income of the average borrower. Borrowers defaulted and they did so at a rapid rate. Houses prices tumbled against the forecasted consensus that house prices never fall. People could not sell their houses to cover their debt. In most cases the debt was more than the market value of the house.

Housing prices dropped 20 percent from their 2006 levels and total home equity dropped from US\$13 trillion in 2006 to US\$8.8 trillion by mid-2008. The increased mortgage delinquencies meant that securities backed by subprime mortgages widely held by financial institutions lost most of their value. By January 2008, the delinquency rate had risen to 21 percent further increasing to 25 percent in May 2008. Widespread repossessions – known in the US as foreclosures – and vacancies followed. During 2007, foreclosures shot up significantly with estimated 1.3 million housing properties repossessed. The sub-prime mortgage bubble had burst.

The effect of the burst of the mortgage bubble coupled with high sub-prime delinquencies was that many banks in the US had their capital dwindled. By mid 2008, it was estimated that as much as US\$435 billion was lost by major banks and financial institutions. And just through October 2008, large financial institutions had reportedly lost almost US\$700 billion in bad loans. That figure excludes losses in hedge funds, pension funds and other highly complex and

leveraged funding arrangements.

The credit market wriggled and credit availability was tightened, and the credit crunch was on. The banks and the other financial institutions have no additional money to lend either to themselves or to their customers.

Given that in real terms wages in the US as elsewhere have not increased in the last two decades, there should have been a decrease in what people could buy with what they earned. However, that was not the case. People did consume and they did so, on a mass scale far in excess of what they earned because of the availability of cheap credits – the credit card phenomenon.

In the late 1990s up to 2007, the share of personal consumption in the GDP of the US increased rapidly from about 66 percent to 72 percent. The trade deficit of the US increased from about 1.3 percent in the 1990s to an average of 4.8 percent of GDP in the 2000s. This meant that the US was consuming more than it was producing. The excess spending and the subsequent consumption binge were made possible by borrowing against houses. Between 2000 and 2007, withdrawals against home equity for personal consumption – making payment on credit cards, and other consumer debts such as refurbishing homes amounted to about US\$2.8 trillion.

SECTION 3

GLOBALISING THE CRISIS

How this American-made crisis spread to the rest of the world to give us the global financial and economic crisis is captured in the maxim “when America sneezes the world catches cold”. The credit squeeze and the near stagnation of real wages in the US led to collapse of consumer spending. The world indeed caught cold because disproportionate amount of global production systems have been linked directly to the infinite gluttony of the US consumer – the export-led growth prescription of the International Monetary Fund (IMF) and the World Bank. Therefore, when the US consumption collapsed, the world stared into the abyss. Global export decreased leading to mass lay-offs and redundancies.

But the present crisis goes beyond the mere collapse of consumption spending in the US. After all, the other major economies in the world particularly Europe and Japan experienced credit squeeze that are directly linked to the sub-prime difficulties in the US. The US banks and financial institutions took their predatory and frenzied speculation beyond the shores of the US. Using the credit at their disposal they sold the toxic (high risk sub-prime mortgages) debts to banks and financial institutions around the world in a complex and shady underground world of financial engineering. Almost every banker in Europe wanted a slice of the US housing boom which was popping up profit levels unimaginable in the prime world of finance.

And so it was that low quality sub-prime mortgages found their way into the entire credit system of the world. Just when the scale of the crisis was becoming manifest in America, sub-prime related difficulties emerged around the world. Finance ministers around the world discovered to their surprise just how deeply American sub-prime loans had infiltrated global finance.

In August 2007, the biggest bank in France – BNP Paribas – suspended redemption from its investments funds because of what it called the ‘complete evaporation of liquidity in certain segments of the US securitisation market’. The British bank, Northern Rock applied for emergency support from the bank of England on the 13th September, 2007, resulting in the first run on a British bank in more than a century¹. A US\$900 million hedge fund in London went under. The list of companies and finance houses that experienced losses is endless. They included the Royal Bank of Scotland, Credit Suisse and Deutschebank among others.

¹ Northern Rock has been offering home loans of up to 125 percent of the home value; 60 percent of its lending was financed by short-term borrowing. The bank was eventually nationalised on the 17th February, 2008 at a cost of £100 billion, it was the first time since the 1970s that the British government have had to resort to nationalisation.

SECTION 4

THE EFFECTS OF THE CRISIS

4.1 The Effects of the Crisis on the Global Economy

The crisis has had serious repercussions on the global economy. It has resulted in a downward trend in the global stock market. Between January 1 and October 1 2008, owners of stocks in US corporations suffered about \$8 trillion in losses as their holdings declined in value from \$20 trillion to \$12 trillion. Like any other globalized phenomenon, the effects of the crises dilated globally with losses of market stocks in other countries estimated at an average of 40 percent (International Coffee Organization 2009).

By August 2008, financial firms around the globe have written down their holdings of sub-prime related securities by US\$501 billion. The IMF estimates that financial institutions around the globe will eventually have to write off \$1.5 trillion of their holdings of sub-prime mortgage-based securities. These losses have wiped out much of the capital of the world banking system. The resultant reduction in bank capital has considerably reduced credit available to economies, businesses and households.

The losses as a result of stock markets and housing value declines restricted consumer spending. Restrictions in consumer spending have negatively affected global business and economic growth. Schmidt-Hebbel (2008) a chief Economist of the Organization for Economic Co-operation and Development (OECD) projected that world trade growth would fall from the 2008 figure of 4.8 percent to 1.9 percent in 2009.

The global economic crisis has significantly affected volumes of international trade. By mid-October 2008, the *Baltic Dry Index* showed that the volume of

shipping fell by 50 percent in one week. This is because the credit crunch made it difficult for exporters to obtain letters of credit. In February 2009, *The Economist* indicated that the financial crisis had produced a “manufacturing crisis”, with the strongest declines in industrial production occurring in export-based economies. China, for example suffered its worst export declines in over a decade. Japan, another export-based economy was also hard hit as its exports declined and GDP fell at an annualised rate of 13 percent. World trade is projected to decline from 4.8 percent in 2008 to 1.9 percent on account of slowdown in global demand. The projected reduction in global trade is also attributed to growth of protectionism as countries raise both tariff and non-tariff barriers to fend off balance of payment difficulties. In terms of growth, estimates for global economic growth rates have been revised downward to 3.7 percent in 2008. The forecast for 2009 remained subdued at 0.5 percent.

The crisis has also engendered negative impact on global labour market conditions. Globally, the International Labour Organization (ILO) has predicted that at least 20 million jobs will be lost by the end of 2009 due to the crisis — mostly in “construction, real estate, financial services, and the auto sector” — bringing world unemployment above 200 million people for the first time.

In terms of poverty, the projections are frightening. Globally, the crisis is projected to add 53 million more to the number of people living below US\$1.25 per day and 64 million more to the number that survive on less than US\$2 in day. Going by the growth projections for 2010, an estimated 73 million inhabitants of the planet will be pushed below the US\$1.25 a day poverty line. A further 91 million more will have to survive on less than US\$2 a day.

4.2 The Effects of the Global Economic Crisis on OECD Countries

As a result of the global economic crisis, the economies of OECD countries have been plunged into intractable difficulties and labour market conditions are rapidly deteriorating in many of these countries (OECD Economic Outlook No. 84, November 2008). It is estimated that unemployment rate in OECD countries would rise. The number of unemployed persons in the OECD countries would increase from 34 million in 2008 to 42.1 million in 2010. The youth, immigrants,

low-skilled, older workers and temporary workers are more likely to suffer from job cuts. Employment in the housing industry and the financial sector are the most affected. Workers in the automobile industry are also not left out of the job cuts as a result of the crisis.

4.3 The Impact of the Crisis on Developing Countries – Africa

The slowdown in global economic consumption and growth is projected to have the most significant impact on the economy of developing countries particularly in Africa. The impact of the crisis on Africa showcases the bankruptcy of the neo-liberal project foisted on the continent through Structural Adjustments. The fundamental premise of structural adjustments was that debt-ridden African countries will grow their economies and improve their competitiveness through investments targeted at export-oriented industries (Jauch, 2009). Inherent in that premise was the fundamental condition that debtor countries needed to repay their debts which are denominated in foreign currencies, especially the dollar.

To achieve that, countries in Africa in particular were ushered into a regime of economic policy making that was geared almost exclusively towards increasing the levels of their exports. The result was dramatic shift in production from meeting local needs towards export-oriented industries. All the countries that pursued structural adjustments under the tutelage of the IMF and the World Bank followed or were made to follow this path. Production systems were modified in ways that allow countries to produce what they do not need themselves. For what they need, the centrepiece of the structural adjustment programme – trade liberalisation – ensured that there was steady flow of imports of all kinds of consumer goods at prices that remove all incentives for local production of these products.

For the past three decades, African economies have been hooked on exports. Export-led industrialisation has become the cornerstone of the national drive for development in almost all the countries. The perceived wisdom is that the only way to industrialise and develop is to increase the levels of exports and it has become almost heretical to argue otherwise.

As the global economy teeters on the brink of depression and global credit dries up leading to collapse of consumption in our export destination countries, Africa stares into the void. Projections continue to be bleak regardless of the method one uses. To start with, the export-orientation project has raised the trade share of GDP of Sub-Saharan Africa to levels that make the region highly vulnerable to even minor declines in export. The share of trade in the continent's GDP increased from 51.9 percent in 1990 to 71.7 percent in 2006. This means that Africa is much more deeply integrated into the global economy than the apostles of neo-liberalism would have us believe.

Given this level of global integration any drop in global consumption and hence demand, however small it may be, is likely to have devastating impact on growth and livelihoods of populations that have for the past three decades been made to survive on export. Economic growth rate in Sub-Saharan Africa was projected at 1.7 percent for 2009. This compares with growth rates of 6.9 percent in 2007 and 5.5 percent in 2008. The slowdown in economic growth will surely impact on employment and poverty levels on the continent.

According to Chen and Ravallion (2009), the current crisis will add 7 million more to the population of Africans living on less than US\$1.25 a day in 2009 and a further 3 million in 2010. This means, ten million more Africans would be classified as poor by the close of 2010.

SECTION 5

THE IMPACTS OF THE GLOBAL ECONOMIC CRISIS ON GHANA

5.1 Introduction

Ghana is one of the countries in Africa that pursued the neo-liberal project of the IMF and the World Bank religiously and to its logical conclusion. In the last three decades, Ghana pursued ultra outward trade policy that recognises export as central to economic growth and prosperity. On the import side, sweeping liberalisation of imports of cheap consumer products was identified by architects of the Structural Adjustments Programme as extremely necessary on one hand for raising consumer welfare and on the other for providing the competition and impetus for domestic industry to be productive and competitive.

Policymakers in Ghana have tended to be persuaded by this textbook logic of economic thinking to the extent that all regulatory and institutional barriers to trade have been removed and tariff walls brought down. National policies have significantly been altered in the past two and half decades to attract investments into export processing industries. With the current downturn in global demand, particularly in countries that have been traditional destinations for Ghana's export, the country is likely to face considerable difficulties in the years ahead.

Among these difficulties include: limited access to international credit, reduced FDI and dwindling foreign exchange from international trade. Other likely effects of the global economic crisis on Ghana are: reduced aid and grants, reduced remittances from Ghanaians abroad and reduction of income from tourism. All these effects have adverse implications for the labour market. They will also impact negatively the ability of the economy to sustain the growth momentum of

the past decade and the continued reduction in aggregate poverty. For a small open economy that is hooked on export-led growth, a slowdown in global demand and hence growth, is likely to impact in an adverse way its ability to grow and to create jobs. And this is what happened for the most part of 2009. In the sub-sections that follow we discuss the impact of the global economic crisis on Ghana's International Trade, labour market, access to credit, FDI, Foreign Aid and Grants, Remittances and the country's financial market.

5.2 International Trade

As indicated earlier, Ghana has in the past 25 years pursued an aggressive export-led industrialisation. The reform of the country's investment codes in the 1980s and the establishment of Export Processing Zones (EPZ) were part of efforts by government to raise the level of export earnings. The sweeping and unbridled trade liberalisation which took hold in the 1990s and got intensified thereafter further demonstrate the commitment of government to the export-led industrialisation dogma.

Ghana's economy has therefore become significantly integrated into the global economy as far as trade is concerned. While not denying the importance of exports in generating foreign exchange and creating employment, its importance in the development dynamics appear to have been overplayed.

Ghana's biggest international trading partners are the OECD countries. Total exports to these countries in 2007 amounted to US\$518 million representing 58.1 percent of Ghana's total export revenue (GIPC, 2008). The OECD countries are the hardest hit by the global economic downturn. These countries as we have seen from the above are currently facing severe credit squeeze which has resulted in cuts in consumer spending and demand.

Consequently demand by manufacturers in the OECD for Ghana's raw materials has fallen and is expected to fall further. According to the Bank of Ghana (2009), Gold price fell from US\$965.90 in March 2008 to US\$803.91 in September 2008 while cocoa price fell from US\$1,377.00 to US\$1,361.10 during the same period. These price drops have been attributed to sharp declines in demand for these primary products as the major manufacturing firms in the OECD coun-

tries got entangled in the crisis.

According to the Institute of Statistical, Social and Economic Research (ISSER, 2008) of the University of Ghana, the three major export commodities of Ghana – minerals, cocoa and timber –together, provide 76 percent of total export revenue. The contribution of cocoa exports to Ghana’s export revenue fell from 31.9 percent in 2006 to 26.3 percent in 2007. The contributions of minerals and timber made marginal gains (ISSER 2008).

The effect of the global economic crisis on Ghana’s international trade, especially export of raw materials is in two fold. First, quantity demanded by foreign manufacturers is likely to fall as a result of declines in consumer spending. Secondly prices of primary commodities in the longer term are likely to be adversely affected. The IMF commodity-price index (fuel + non-fuel) peaked in July 2008 at 218 (2005 = 100). The index dropped to 98 in December 2008, its lowest level². The effect of these is that current production levels would not yield for the country the previous revenue levels and this can further deepen the already precarious balance of payment situation.

While Ghana’s exports revenue from some commodities reduced and others experienced marginal increases, import increased significantly. As demand for Ghana’s exports continue to fall and may fall further, the national demand for imports will continue to increase because the export-led growth and trade liberalisation strategy that the country has embraced has led to a situation where the country produces what it does not consume and consumes what it does not produce. According to the Bank of Ghana (BoG) (2009), total merchandise import increased by 23.6 percent to US\$10,260.9 million at the end of December 2008 from a level of US\$8,066.1 million in 2007. The overall balance of payments recorded a deficit of US\$940.7 million at the end of December 2008, reversing a surplus of US\$413.1 million in 2007 (Bank of Ghana 2009).

In 2009, provisional estimates from the Ministry of Finance and Economic Planning show export earnings of US\$4,229.7 million which represent 3.8 percent increase over the 2008 level. The increase was mainly on account of higher price

² As has been the case historically, commodity prices have fallen far more than industrial prices since commodity supply cannot be adjusted quickly when demand falls.

of cocoa and gold for the 2009 fiscal year. The price of cocoa, on the world market increased, by over 30 percent in 2009. However, the total volume of cocoa export declined by 16.6 percent to 382,422 tonnes in 2009 from 458,426 tonnes in 2008. The increase in revenue from gold is also the result of increases in gold price in the past year. The volume of gold export actually remained flat between 2008 and 2009.

The current hikes in the world market prices of cocoa, gold and other primary products cannot be sustained into the future. The continued depreciation in the value of the dollar is linked to the upsurge in world market price of commodities. In addition, the rising prices are themselves the result of speculation by profit-hungry corporations who speculate on the prices of these products and in the process drive up their prices.

The impact of the crisis on Ghana's trade is further reflected in the declining levels of international trade related taxes. Even before the global economic crisis gained currency in mid 2008, the country was experiencing declines in international trade taxes. From 2006 to 2007, tax from international trade as a percentage of total tax revenue fell from 23.29 percent to 17.41 percent (ISSER 2008). Of much significance is the fall in export duties.

While import duties increased from 76.96 percent in 2006 to 94.19 percent in 2007, export duties fell significantly from 23.04 percent to 5.81 percent during the same period. Ghana has started feeling the impact of the global economic crisis on her exports. Excessive imports in the face of reduced exports affect the value of the local currency – the Ghana Cedi – and as the prices on the local market shoot up, the burden of rising prices affect the purchasing power of workers placing them in increased economic hardship.

5.3 The Labour Market

The credit squeeze and the subsequent shortfall in global demand have resulted in rising global inventory – over production and accumulation. The prolonged stagnation in wages has meant that people can only consume out of credit. Supply no longer creates its own demand. When the credits that fuelled the pre-crisis consumer binge dried up, businesses did not only fail to hire more labour but

were actually compelled to fire those on their payroll in order to stay afloat. According to projections by the International Labour Organisation (ILO), more than 51 million workers are likely to lose their jobs by the end of 2009. Twenty-three million of these people will be in developing countries. This will bring the number of the unemployed in the world to about 240 million. For those who will survive the crisis and keep their jobs, many will be in insecure jobs and receiving very low wages.

It was always going to be difficult to estimate the impact of the crisis on the Ghanaian labour market given the paucity of labour market data in Ghana. However, the declining FDI (see section 5.5) and the associated declines in export volumes are indicative of the troubles that the crisis portends for the labour market. Indeed, the crises have directly affected employment levels in the timber industry in Ghana which has in the past focused almost exclusively on export.

Data from the Timber and Wood Workers' Union (TWU) of Ghana Trades Union Congress (TUC) indicate that over one thousand (**1040**) workers in the timber industry have lost their jobs by the end of February 2009 through layoffs by management. Most of these companies are export oriented companies, exporting between 85-90 percent of their products. As the crisis has affected the construction industry in most OECD countries (where most of Ghana's timber exports are destined), demand for Ghana's timber has dwindled. Some of the timber companies have stockpiles of veneer and other timber products that they cannot export because they have receive no orders from their foreign clients. Managements of these firms have resorted to mass lay-offs of their workers to stay afloat.

5.4 Access to Credit

International credit is an important source of finance for Ghana's development. Ghana has traditionally accessed both multilateral and bilateral credits for the execution of development projects. As international financial institutions and lending countries are faced with liquidity problems as a result of dwindled capital, very little resource would be available for credit. Most of Ghana's lending countries are the OECD which have been severely hit by the crises and are therefore spending colossal sums in several economic stimulus packages to rescue their financial and industrial firms. Consequently, accessing both syndicated and

bilateral loans would be problematic for Ghana.

The effect is that this alternative financial resource hitherto available for social and infrastructural investment would be severely restricted. In this situation, less money would be available for the provision of potable water, improvement of the energy situation and the provision of other social services. Reduction of government's expenditure on these social services would put excessive pressure on ill-paid workers.

At the domestic level, credit conditions survey undertaken by the Bank of Ghana in December, 2008 showed a general tightening of credit conditions for enterprises in the fourth quarter of 2008 (BoG, 2009a). The Bank of Ghana raised borrowing rates from 16 percent in July 2008 and further to 18.5 percent in February 2009 as it sought desperately to calm inflationary expectations. The increases in the bank prime rate fed into generalised increases in interest rates which affected the costs of doing business.

5.5 Foreign Direct Investment (FDI)

FDI plays an important part in Ghana's economy through the injection of capital into the economy as well as job creation. The global economic crisis has put a strain on global capital. Ghana is likely to face significant difficulties in attracting FDI as a result of the crisis. As global capital dwindles, Ghana like many other developing countries which are traditionally less attractive to FDI, would experience further decline in the already little FDI it receives annually.

According to the Ghana Investment Promotion Centre (2008), by the first quarter of 2008, of the top ten FDI in Ghana, 6 were from OECD countries totalling US\$4.7 billion and representing 95.9 percent of total FDI. Data from the GIPC showed that Foreign Direct Investment (FDI) to Ghana more than doubled from US\$2.3 billion in 2006 to US\$5.3 billion in 2007. Between 2007 and 2008 however, FDI declined by 16 percent to about US\$4.4 billion. A total of 321 projects were registered in 2007 compared to 305 in 2008. In line with the generalized decline in investment projects, the quantum of jobs expected to be created by FDIs declined from 33,787 in 2007 to 30,056 (GIPC, 2008). In 2008, FDI inflows decreased by about 500 percent from US\$1.2 billion to US\$0.2 billion between the

third and fourth quarters of the year (Ackah et al, 2009; GIPC, 2008).

5.6 Access to international Aid/Grants

Foreign aid/grants have been very important in supplementing Ghana's budget over the past years. In 2004, aid/grants reached as high as 20.39 percent of Ghana's total revenue (ISSER 2008). However between 2006 and 2007, aid/grants as a proportion of total revenue fell from 19.89 percent to 19.01 percent. In 2008, according to the Bank of Ghana (2009), grants received fell to GH¢817.3 million (4.7 percent of GDP) from GH¢857.2 million (6.1 percent of GDP) recorded for 2007.

It expected that international aid/grants would be further affected by the global economic crisis. As the major economies that provide Ghana with aid are experiencing recession, their benevolence is likely to be affected.

5.7 Remittances

The importance of remittances from abroad for the survival of most Ghanaian households and injection of money into the economy cannot be gainsaid. Remittances play an important part of the nation's economy (ISSER 2004). According to Addison (2004) not only are inflows of remittances from abroad to Ghana higher but they are also more stable than Official Development Assistance (ODA) and FDIs.

According to the Bank of Ghana (2009), remittances (private inward transfers) received through the banks by the end of 2008 amounted to US\$8.7 billion, which represents a 26.8 percent increase over 2007 figure. However, inflows for the months of October and November 2008 when the global financial crisis had become apparent were US\$654.8 million and US\$608.0 million respectively. The October and November 2008 remittances were lower than the inflows for the same period in 2007 which were US\$787.3 million and US\$614.9 million respectively.

The December 2008 remittances (private inward inflows) of US\$990.2 million was however, higher than that of December 2007 figure of US\$718.3 million. The higher December inflows are explained in part by the Christmas period where remittances are usually high. Ghana had started experiencing strains on remit-

tances (private inward transfers) as a result of the global economic crisis. The slowdown in remittances has been the result of job cuts in the US and Europe which has affected migrant workers including Ghanaians. In times of economic downturns, immigrants workers are the most likely to suffer from job losses and therefore Ghanaians abroad are likely to be affected. The effect is that households which depend either in part or wholly on remittances from abroad would face serious economic hardships.

In addition, as remittances from Ghanaians abroad is reduced, artisans such as masons, carpenters and others who earn their incomes by working on projects of Ghanaian migrants abroad would have their source of livelihood seriously affected. It should be noted that quite a sizeable percentage of remittances from abroad goes into building of houses in Ghana. Thus the growth rate of Ghana's housing stock may also be affected.

Also remittances provide means of injecting additional funds into Ghana's economy. Therefore as remittances from Ghanaians abroad are reduced as a result of the global economic crisis, fewer funds than what used to be the case would be injected into Ghana's economy. The large declines in the value of the cedi against other major currencies experienced in the first part of 2009 are partly explained by the fall in remittances.

5.8 The Financial Market

Ghana's financial market is not strongly linked to the global financial market. The Ghana Stock Exchange (GSE) is primarily domestic with majority Ghanaian investors. We should therefore expect less impact of the global financial crisis on the financial market. The bulk of the GSE stocks traded are denominated in the local currency.

While the financial crisis resulted in losses by owners of stocks in U.S. corporations to the tune of \$8 trillion, stocks on the GSE made significant gains. According to a half yearly report by the GSE (2008), investors made enough gains as the All-Share-Index move from 6,718.88 in January 2008 to 10,346.30 by June the same year representing 56.8 percent gain. During the same period, market

capitalization shot up by 24.6 percent from GH¢12,513.05 million to GH¢15,587.76 million. On the volume and value of shares, the half yearly report indicates increases of 36 percent and 150 percent respectively. In absolute terms, by mid 2008, there was a total of 189.08 million shares valued at GH¢196.53 million as against 135.85 million shares with total value of GH¢78.61 million for the same period in 2007.

The relatively robust stock market activities on the domestic bourse in the era of global financial and economic crises are a reflection of how limited Ghana's financial market is integrated into the global financial system. It also shows the wisdom in gradual and step-by-step integration as opposed to the folly of rush and unguarded global integration. However, although it is not expected that stock levels would go down, the possibility of achieving the 2008 growth would be less likely. This is because the credit squeeze would most likely affect resources available for people to invest in stock markets.

If the possibility of improved investment in the stock market is lower, firms using the GSE as a means of sourcing for funds for capital injection are going to experience some difficulties. In this situation, expansion is likely to suffer and that could have significant impact on the ability of businesses to employ more people. In addition, subdued growth of businesses could have significant negative impacts on overall economic growth rate of the country.

SECTION 6

RESPONSES TO THE CRISIS

6.1 Responses by Developed Countries

One immediate impact of the financial crisis was a rapid cessation of bank borrowings from the wholesale or inter-bank money market. Large scale mortgage delinquencies had turned bank investments in highly leveraged sub-prime mortgages into illiquid investments. Banks and other financial institutions found it almost impossible to raise fresh money for refinancing as they stopped lending to each other overnight. At the same time, the collapse in September 2008 of Lehman Brothers precipitated a run on the US money market. The credit freeze quickly spread from the wholesale to the retail market: banks stopped in quick succession lending to their customers.

A flood of rescue packages went into force as country after country raced in a desperate attempt to save not only their financial systems but more importantly their entire economies from collapse. In September, 2008, The US announced a US\$700 billion rescue package, under the Troubled Asset Relief Programme (TARP) to buy distressed assets. This was followed by a promise to make additional US\$600 billion available for the same purpose. In October, the British government announced £37 billion stimulus package to buy 'preference shares' in distressed banks. This was after it had been forced to take 43 percent stake in the Lloyds Banking Group, 58 percent stake in the Royal Bank of Scotland and 70 percent stake Northern Rock.

In October 2008, governments in the US and the EU committed themselves to coordinate their 'recapitalisation' efforts towards saving their banking system from

collapse. The recapitalisation focused on buying shares in distressed banks (nationalisation) in addition to buying toxic assets on bank's balance sheet.

The recapitalisation endeavour together with the contingent guarantees were intended to provide banks with the necessary equity infusions so that they (banks) could resume lending both at the wholesale and retail windows. But the banks took the money and pocketed them. Credit conditions continued to tighten throughout 2009 and banks continued to register significant losses. The liquidity crisis – inability of banks to borrow on the inter-bank market to meet their current liabilities – had turned into a solvency crisis – insufficiency of bank capital to cover liabilities. A second round of bank rescue package became necessary and this entailed complete nationalisation of banks.

Another classic response to the credit squeeze came in the form of quantitative easing – making money cheap and encouraging people to borrow. This entails cutting interest rates which has become a normal response to economic downturns. But interest rates cut has its own limitations and the current rates cut have crystallised these limitations. The falling value of banks investments have compelled them to widen the spread between the inter-bank rate and lending rate (cost of borrowing) to compensate for their losses. Before the onset of the current crisis, the spread between the three-month dollar LIBOR (inter-bank rate) and the three-year mortgage-rate average was 0.97 percent; by February 2009, it had increased to 3.87 percentage point. In addition, the falling prices that is associated with recessions of this magnitude meant that the real (inflation-adjusted) interest rate would rise since normal interest rate cannot fall below zero.

Above all, since investments are not determined solely by borrowing cost but also by profit expectations and since profit expectations diminish in all economic downturns, it will be hard to find people borrowing. Increasingly, the crisis is shifting from one of lending crisis to spending crisis: households and businesses are refusing to borrow notwithstanding the fact that money has been deliberately made cheap.

6.2 The Domestic Response

In Ghana as in much of Sub-Saharan Africa, the response to the crisis has oscil-

lated between denying the impacts of the crisis on the domestic economy and a false sense that the economy is strong enough to withstand the impacts of the crisis to a tacit admission that the economy is smarting under the impact of the crisis. The pre-crisis export boom, begun, their descent but imports actually surged as domestic demand remained strong. In 2008, the Ghanaian economy registered its worst trade and budget deficits in recent times.

The response has so far been a return to the IMF which has prescribed the usual pro-cyclical economic policies reminiscent of the days of structural adjustments. Rather than sustaining the strong domestic demand and diverting that demand to domestic products in support of domestic industry, the stabilisation programme agreed by government of Ghana seeks among others to dampen domestic demand.

While countries around the world including emerging economies are spending their way through the storm generated by the crisis; running large deficits to breathe life into their failing banks and stimulate their economies, the government of Ghana had agreed with the IMF to radically slash the budget deficits in ways that threaten growth. Although the budget deficit of 2008 was large and unsustainable, to slash it into half within a matter of one fiscal year was to sacrifice growth and sabotage employment creation and poverty reduction all in the context of hostile global environment.

Part of what government agreed to do in its efforts to deal with the deficits was to cap the wage bill by deferring the implementation of the Single Spine Pay Policy (SSPP). Government also agreed to implement a policy of net hiring freeze in the public sector, keeping the numbers on government payroll at the end-2008 level. The programme also includes a freeze on what it calls “grade inflation” which simply means a moratorium on promotions within the public sector. Thus, while others are making frantic efforts to stem the growing tide of joblessness including expanding the public service, the Ghana government had negotiated away its sovereign rights and indeed obligation to put Ghanaians to work.

In its own assessment, the World Bank estimated that achieving the inflation target for 2009 would mean that GDP growth would slow down to 4.5 percent per annum and should there be a further deterioration of the global economic envi-

ronment, GDP can only grow at a marginal rate of 2 percent, which translates to a decline in per capita terms.

Part of what government needed to do to achieve the macroeconomic targets set out in the Stabilisation Programme include reductions in energy and utility subsidies as well as raise the level of taxation. These will further constrain per capita private consumption and increase income poverty.

SECTION 7

CONCLUSION

In this paper we have tried to explain in the simplest way possible, the raging financial and economic crisis that has engulfed the world. As we have seen, the crisis began in the housing market in the United States. The collapse of housing prices in 2008 led directly to default on mass scale, particularly among beneficiaries of sub-prime loans. Securities that backed the sub-prime loans largely held by banks and other finance institutions lost much of their value and with it much of the capital base of the financial institutions. The crisis quickly mutated from the financial system to the real economy because the banks that have been the source of cheap consumer credit that fuelled the largest and longest consumption binge in the US suddenly ceased lending not only among themselves but also to their customers.

The crisis spread to the rest of the world because the banks and finance houses in the US sold their high-risked sub-prime mortgages and other complex financial products to others banks particularly banks in Europe. The drying up of consumer credit also affected global demand and export and as has been noted, the financial crisis quickly turned into a manufacturing crisis. Countries whose financial systems were not so much integrated into the global financial architecture were affected because much of their production systems have been geared toward export mainly to the US and Europe.

The underlying cause of the crisis was what many have labelled as 'blind faith' in the ability of the market to regulate itself and check excesses. The inability or unwillingness of national authorities to regulate the shady underworld of finance and the complex array of securities that were being churned out believing as

they did that the invisible hand of the market would regulate the market created this crisis. The response so far has been to bail out the banks and recapitalise them to resume lending and rescue consumer spending. The global clarion call has been to regulate the activities of the banks and finance institutions. The rhetoric of ‘regulation’ has been an important lexicon in the various rescue programmes, yet no concrete proposal has been put forward and it appears the powers that be are not interested in it.

Without proper and well-crafted regulation that rein in on risky behaviour and changes the balance of incentives within the banking system, the current episode of bailouts would only result in scratching the surface of the problem. The system of casino capitalism would be left intact. Thus assuring those whose risky behaviour tipped the world into the ‘Great Credit Crunch’ (GCC) that they can always pocket (privatise) their profits but their losses would be socialised – the rest of society will be there to share in their losses.

On the domestic front, the national development framework of export-led growth has been the main conduit through which the current crisis has affected the country. There is evidence of declining export volumes. Export revenues have been spared from falling only by recovery of cocoa and gold prices. Foreign Direct Investments have gone down considerably and so are remittances, and foreign loans and grants. There have also been job losses particularly in sectors that have been oriented towards the export market. All these show that despite earlier attempts to deny the impacts of the crisis, the Ghanaian economy has had its fair share of the negative impacts of the crisis.

The domestic response should be to sustain the current levels of domestic demand rather than dampen it. Policies should be directed at diverting domestic demand towards domestic product in support of the budding domestic industry. This would require taking another look at the export-led growth strategy. It would be difficult and almost impossible to deny the importance of exports in the economic growth process. However, it would be equally difficult to understand a growth strategy that seeks to build firms that are competitive on the fiercely competitive global export market even when those firms have no grounding in the domestic market. We would submit that part of the growth menu should be to secure, by whatever means possible, a sizeable proportion of the domestic mar-

ket for domestic firms. This should be the obvious starting point in the national efforts to build globally competitive firms.

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