INTRODUCTION TO THE ECONOMY OF GHANA

THE EXTERNAL SECTOR
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• This is one of the most important sectors of any economy in modern times, especially since the last 40 years.

• We are now in a highly integrated global economy; hence this sector holds great potential for growth and transformation.
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- Countries that have experienced rapid growth in recent decades, such as China, India, Brazil as well as those before them, such as Korea, Taiwan, Singapore, Malaysia have grown faster because of the growth of their external sector.
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• Therefore without the external sector, we would be much poorer.

• Nevertheless, there are downsides to engaging in international transactions.

• However, on the whole we are better off engaged in trade than not.
In terms of accounting for the external sector performance, the Balance of Payments Accounts, which are part of the National Income Accounts helps in understanding the factors influencing the external sector.
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The Balance of Payments Accounts are the record of a country’s international transactions.

This is made up of two main accounts:
- Current account
- Capital account
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• The current account measures the country’s trade in currently produced goods and services, along with unilateral transfers between countries.

• For convenience we sub-divide it into three: Net Exports; Net Income from Assets; Net Transfers
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• The capital account captures/records trade between countries in existing assets.

• Thus, if we sell an asset, say a factory or company to a foreigner it is recorded as a capital inflow.
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• By similar reasoning, when we buy an asset from a foreigner/abroad, such as obtaining a Swiss account or penthouse in Dubai, it is recorded as a capital outflow.

• The other main account in the Balance of Payments Accounts is the Official Settlements Balance.
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• The Official Settlements Balance records transactions conducted by the Bank of Ghana.

• This account records transactions in official reserve assets, such as gold, foreign exchange holdings, foreign governments’ securities, foreign bank deposits, special drawing rights at the IMF.
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There are several indicators of external sector performance:

- Level of openness (measured as the sum of exports and imports as a percentage of GDP)
- The size of the economy in relation to the rest of the world (trade intensity)
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• The current account balance as a share of GDP

• The capital account balance as a share of GDP

• Reserves of foreign exchange
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• Inflows of foreign direct investment as a share of GDP

• External debt as a share of GDP

• Movements in the foreign exchange rate

• Remittances as a share of GDP
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Exports and Imports as a Share of GDP: 1960 - 2015

- Blue line: Imports of goods and services (% of GDP)
- Red line: Exports of goods and services (% of GDP)

Years:

% of GDP: 0 10 20 30 40 50 60 70 80
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External balance on goods and services (% of GDP)

Lecture Material Prepared by Dr. Emmanuel Codjoe
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Personal remittances, received (% of GDP)

Year: 1979 to 2015

% of GDP

0 1 2 3 4 5 6 7 8 9 10 11 12 13 14

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Why the External Sector Matters?

• We have seen earlier its impact on economic growth. More generally, countries that are more open tend to grow faster.
Why the External Sector Matters?

- Other benefits to Ghana include:
  1) Access to foreign goods and services, especially those that are not/cannot be produced locally.
  2) Access to foreign markets for domestically produced goods and services.
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Why the External Sector Matters?

3) Access to foreign expertise and know-how as well as to technology and capital that is needed for development.

4) there is increased diversity and variety in respect of the goods and services available to Ghanaians.
Why the External Sector Matters?

5) There is increased competition which forces domestic firms to increase their level of efficiency, productivity, and competitiveness.
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• Despite these benefits, there are vulnerabilities arising from increased participation in and growing links with the world economy.

• There is increased inequality between and within countries as a result of expansion in world trade and investment.
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• Heavy reliance on the exports of commodities imply the country is exposed to vulnerabilities resulting from volatility in the commodity markets.

• This is especially so, when we consider that Ghana has a high degree of openness measured as \((X + M)/\text{GDP}\).
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• This vulnerability is worsened by the fact that a substantial portion of foreign exchange from exports, which are usually marketed in dollars.

• Moreover, we are not in a position of being price-makers, and therefore heavily dependent on the fluctuations of the world price on commodities we export.
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• Greater export price volatility has adverse effects on government revenue because of the share of trade taxes in total revenue.

• There is also concern about the effect of trade on the environment. Most commodities exported are environmental resources.
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• There also several concerns about the effect of cheap imports on domestic firms’ competitiveness as well as their operational viability.

• There also constraints on domestic economic policy making, because of membership of international organizations as well as the workings of the world economy.
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• The basic income-expenditure macroeconomic model yields important relationships between the external sector and domestic economic situations, as well as other implications for the economy as a whole.

• One such relationship is the twin deficit hypothesis.
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• The **twin deficit hypothesis** suggests that fiscal deficits lead to current account deficits.

• Thus a wider fiscal deficit should be accompanied by a wider current account deficit.

• The twin deficits are usually front and centre of many an economic policy debate.
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• To illustrate this point, let us begin from the sources of spending perspective:

\[ \text{GDP} = \text{C} + \text{I} + \text{G} + (X-M) \]

• From the uses of income perspective:

\[ \text{GDP} = \text{C} + \text{S} + \text{T} \]

• By equating these two, we obtain:
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\[ C + S + T = GDP = C + I + G + (X-M) \]

- So after re-arranging this we get the sectoral balances view of the national accounts:

\[ (S-I) + (T-G) = (X-M) \]
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• The private saving (private domestic balance) \((S-I)\) is positive if in surplus, negative if in deficit.

• The budget deficit \((T-G)\) is positive if in surplus, negative if in deficit.

• The current account balance \((X-M)\) is positive if in surplus, negative if in deficit.
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• Thus, \( CA = (X-M) = (S-I) + (T-G) \)

• If assume that private domestic balance (savings and investment) are stable over time, then the fluctuations in the government’s budget position will be fully translated to the current account.