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CEPA warns of Dutch Disease as Ghana moves from cocoa to oil economy



The Centre for Policy Analysis (CEPA) warns that Ghana's economy is likely to suffer the phenomena known as the Dutch Disease when the country begins commercial production of oil.

It says as Ghana enters the oil era, an exchange rate effect symptomatic of the Dutch Disease is expected. The exchange rate effect, together with the yield on Ghana's Eurobond source of information on the country risk premium on Ghana and the rate of inflation would be key considerations in the deliberations of the Monetary Policy Committee (MPC) of the Bank of Ghana (BOG) for the determination of both the real and nominal policy rate (prime rate).

Ghana is set to become part of the global oil producing nations when commercial oil production begins in the Jubilee oil field in December 2010.

While observers of the oil global industry say Ghana will not be a major provider, they are of the view that the country will become a major player in the oil industry. They attribute this to the country's globally acclaimed democratic credentials as a beacon of political maturity in Africa.

CEPA believes that Ghana's economy which has been largely based on Cocoa will become an oil economy following the start of commercial production of oil.

In an analysis of the economy sent to ghanabusinessnews.com, CEPA postulated that the Ghanaian economy appears set to move from what may be called a cocoa economy to an oil economy.

The discourse is part of a publication that CEPA launches Friday May 28, 2010.

It said considerable investments were made in cocoa at the turn of the last century. From about 1911, cocoa cultivation emerged as the dominant productive activity in the country. Since then, the cocoa sector has served as an important source of:

- livelihoods and employment;
- central government revenue; and
- foreign exchange earnings.

Thus, over the last 100 years, in a fundamental sense, Ghana could be said to have had a cocoa economy.

The key structural characteristics of the economy of Ghana include the following:

A highly open economy relatively well-integrated into the global trading system and critically dependent on three commodities namely cocoa, gold and oil. A standard measure of openness to international trade (the ratio of the value of trade for both exports and imports to the nominal GDP) stood at nearly 100 percent for Ghana compared to about 75 percent for la Cote d'Ivoire, just under 60 percent for Nigeria and less than 50 percent for Tanzania (using 2008 data). These statistics show why Ghana is often characterized as highly open and well-integrated into the global trading system.

Revenue from international trade constitutes a significant proportion of the total government revenue; tariffs are relatively low and so is the dispersion across import items.

The exchange rate and payment system has been described as a liberal one in the sense that the system is free from restrictions on payments and transfers involving merchandise trade, profits, dividends and labour incomes as well as official grants and private transfers such as remittances. A consequence of this freedom from payment restrictions, however, is that domestic prices of traded goods and the exchange rate are highly responsive to international market forces and domestic demand pressures.

The official accounts time Ghana's entry into the oil era for the fourth quarter of this year 2010. The World Bank for its part, projects that Ghana's oil will start to flow in early 2011. Regardless of the exact timing, however, the promise of oil generates high expectations.

Anecdotal evidence has it that some Ghanaians desire that the exchange rate of the cedi reverts back to parity with the US dollar. In CEPAs view that would be the onset of the Dutch Disease.

The Dutch Disease is so named because of the destructive effect such as choking off the growth and employment potentials in non-oil sectors on the Dutch economy of the discovery of substantial gas reserves in the 1960s. It is a form of the resource curse. It originated from the nominal and real appreciation of the exchange rate that resulted from the large inflows of foreign exchange earnings from the Dutch export of gas. Effective management of the exchange rate will therefore be critical, if oil is to enhance our growth prospects and if Ghana is to avoid the ills of the Dutch Disease, it said.