HISTORICAL LOOK AT THE IMPACT OF GLOBAL DEVELOPMENT PHILOSOPHY ON DEVELOPMENT FINANCING INSTITUTIONS (DFIs): THE CASE OF GHANA

DODOO-AMOO ERIC NII AMU OKOTOKATA
eric2019@isscad.pku.edu.cn

Prologue: Ghana was reputed as a country with immense developmental potential in sub-Saharan Africa when it gained independence in 1957. However, these blueprints have still not been attained after 64 years. This article covers the three-round of world development philosophy, its impact on DFIs and discuss in particular its impact in Ghana to explain the economic phenomena in Ghana and the current economic trend around the world.

At the time of gaining independence in 1957, Ghana was reputed as a country with immense developmental potential in Sub-Saharan Africa. Based on its natural resources and endowments, the new independent government formulated a series of different development plans to achieve rapid industrialization and agricultural development. However, these blueprints still have not been attained after 64 years. In fact, Ghana has over a long-time been facing increasingly monumental development financing challenges, especially in sectors having high-growth potentials like the industry and agriculture sectors.

What kind of role should the state play in fostering access to finance? Conventionally, there are two contrasting views: the “interventionist view” and the “laissez-faire view.[1] The interventionist view supports state intervention in the provision of financial services. The laissez-faire view opposes state participation due to the distortions considering the possible distortions, which is a mainstream view in academia.[2]

For instance, in low-income countries, weak governance often leads to the breakdown of institutions and the misappropriation of resources.[3] As a result, these poorly performing state-owned banks tend to impede financial sector development. However, this is not the case in high-income economies. Taking Germany as an example, nearly 25% of loans in the 1980s were either originated by state agencies or carried state guarantees. Besides, from 1995 to 2007, government-owned banks were more stable than private ones though less profitable.[4]

Development Financing Institutions (DFIs) are financial institutions established to support underserved segments of economies, such as agriculture, infrastructure, small and medium-sized enterprises, and affordable housing. So far, many countries have established DFIs irrespective of their economic status.

---

[1] (Martinez, Vincente, et al 2017)
[2] Ibid
[3] (La Porta et al. 2000)
[4] (Beck et al. 2009)

From the 1950s to the 1970s, a booming number of DFIs were established in response to Structuralism in the first wave of development philosophy. At that time, it was widely thought that the market had encountered insurmountable defects, so the states should turn to import substitution industrialization. Some scholars suggested that for countries that want to avoid exploitation from advanced nations, they had to build a new structure where the imports are replaced with domestic production.[5] In other words, the state should take the initiative to develop advanced capital-intensive industries and create an internal market to fulfil self-sufficiency.

By the end of WWII, the indigenes in the Gold Coast started to agitate against imported goods and this later evolved into demonstrations and boycotts by the indigenes. Faced with these protests, the colonial administration had to adjust its policies to facilitate private Ghanaians' participation in commercial activities. In 1952, the Gold Coast Industrial Development Corporation (GCIDC) was established to provide loans for Ghanaian businesspeople.

Ghana gained political and economic independence in 1957. This was a time when Structuralism had gained ground, and the view that the Government should play a dominating role in economic activities was the order of the day. In Ghana, a series of import-substitution industrialization and development plans were enacted for its post-independence reconstruction. To finance rapid industrialization, the former GCDIC transformed into Ghana Industrial Development Corporation (GIDC) and eventually turned into the National Investment Bank (NIB) on March 22, 1963, which was the first Ghanaian development financing institution. The

[5] . Prebisch (1950) and Singer (1950)

main function of NIB was to support the state in leading the establishment of advanced capital-intensive industries and a self-sufficient internal market.

Unfortunately, these policy directions defied Ghana's endowment structure. Consequently, these policies, together with the market failures, caused the failure of most industrialization plans and interventions. The economic deterioration began in the mid-1960s and worsened in the 1970s.

In the 1980s, Neoliberalism stressing privatization, liberalization, and deregulation to compensate for deficiencies in Government failure, became the leading philosophy around the world. Neoliberal economists emphasized non-intervention from Government and rejected market regulation as inefficient.[6] In those days, DFIs in developing countries started facing declining pressures for being vulnerable to excessive Government intervention, resulting in the misallocation of resources, towering debts, and corruption. As liberalization, deregulation, and privatization were highly pursued, some banks were closed or liquidated, and others were merged into commercial or investment banks.

By the end of the 1980s, Ghana realized its economic crisis with recorded negative growth rates and a breakdown in the functions of institutions and incentives system. In the context of

[6] Milton Friedman and Anne Krueger

neoliberalism, Ghana's economic woes were resulted from inappropriate internal policies designed and implemented to substitute the roles of the markets with state controls.

During the second wave of development philosophy, NIB realigned its mandate to start taking deposits as it realized that merely relying on the annual National Budget allocation to run the bank was not sustainable. Besides, during 1975 and 1980, NIB broadened its funding sources by borrowing funds from internal financial agencies. However, economic situations were not conducive to accessing external credit. By the early 1980s, economic mismanagement coupled with high reliance on fluctuating world commodity markets had already caused the collapse of Ghana's economy. After that, the production and export collapse also led to revenue shortfalls, leaving a self-destructive debt-driven cycle where the survival of the economy relied on the procurement of external loans. NIB resorted to mobilizing local deposits to fund industries to address this dilemma of not being able to access external credit.

In July 2011, Ghana rebased its National Accounts. The results showed that the Ghanaian economy transcended into lower middle-income status faster than expected. In light of this new economic classification, the government faced dwindling external concessional funding for development purposes and had to look for new funding streams to finance its huge infrastructural deficit. As a result, the complexity of new funding modalities caused the stalling of its developmental programmes and policies.

The first and Second waves of development thinking were about government dominance and the free market. While the former focused on import substitution, defying the nation's endowment arrangement and market failure, the latter stressed on Washington consensus, defying the nation's level of growth and Government failure. These two development theories led to stalled development plans, corruption, scarcity of funding, inefficiency, and costly transactions for a lack of soft and hard infrastructure.

In recent years, with the failures of Structuralism and Neoliberalism, New Structural Economics was proposed, which calls on the renaissance of DFIs to finance structural economic transformations on endowment structure, comparative advantages, and the need for a combined government and market.[7] Both academics and policymakers came to realize the significance of DFIs in playing countercyclical roles, bridging infrastructure financing gaps, addressing defects in capital markets, and enhancing structural transformation.[8]It is predicted that the roles of DFIs within the 21st century is going to be determined by the preference of society as well as the prevailing development concept and the economic environment, also influenced by their history and legacy, that is, the experience they have gained and the evolution they have lived through in the second half of the 20th Century.[9] The state plays a critical function in financial markets, making it im8perative that interventions be well-designed.[10]

[7] (Bruck, 1998)
[8] (Xu, et al 2019)
[9] (Bruck, 1998)
[10] (Stiglitz, 1994)

However, there is still a research gap in demonstrating why DFIs can play a better role in fixing market failures than alternative options like a public-private partnership, issuance of Government bonds, and incentivizing private commercial banks to undertake development financing. Considering that, some scholars call for a more proactive market incubating role, including promoting mission-oriented innovation, incubating market institutions, and nurturing capital markets.[11]

Mr. Eric Nii Amu Okotokata Dodoo-Amoo is a Senior Economist with the Treasury and Debt Management Division of the Ministry of Finance Ghana. Eric has extensive working experiences covering structuring concessional finance for government projects, credit risk assessment of State-owned enterprises, investor relations and public debt management as well as a deep understanding of Government machinery and policies. His interest in global development includes International Economic Cooperation, Development Financing Institutions and Rural Economics. Eric holds a bachelor's degree in Law and Economics from Kwame Nkrumah University of Science and Technology Ghana, a master's degree in Economic Policy Management from the University of Ghana, another master's degree in International Economics from the University of International Business and Economics (UIBE) Beijing, China and currently a Doctoral candidate in Theoretical Economics (National Development) at the Institute of South-South Cooperation (ISSCAD) Peking University, Beijing China.

---

[11](Xu, et al, 2019)