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The Role of Fiscal Policy in the Development of the Ghanaian Economy

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Abstract

The purpose of this research was to review the influence or effect of fiscal policies on Ghana's development based on a survey of the available literature. This was accomplished by conducting a systematic internet search using an array of keywords—fiscal policy, fiscal policy in Ghana, challenges of fiscal policy in Ghana, challenges of fiscal. We find that there is a large body of empirical research on the impact of fiscal policy on growth in Ghana, with varied results based on cross-sectional, time-series, and panel data. The economy benefited from government investments, transfer payments, and tax income, while government consumption had a negative impact.

Keywords

Fiscal Policy, Tax Income, Macroeconomic, Transfer Payment

1. Introduction

Traditional Keynesian macroeconomic arguments regarding economic development have focused on monetary policy, economic structure, and fiscal policy of economic outcomes (Agbobli et al., 2019). Fiscal policy is one of the tools available to economy managers to steer the health of an economy (Havi & Enu, 2014). It is the view of the Keynesian that fiscal policies exert greater influence on a country's economic activities (Khosravi & Karimi, 2010) cited by (Havi & Enu, 2014). Fiscal policy is a strategic instrument available to governments in achieving projected macroeconomic objectives (Ekundayo & Ismaila, 2019; Havi & Enu, 2014). As a demand-side policy, it involves one of two things; to increase or de-

crease taxation, or check government spending. It has been established by (Ekundayo & Ismaila, 2019) that, market mechanisms and monetary policy cannot be depended on exclusively to stimulate the economy unless fiscal policy plays a complementing role. More than requiring a mix, the argument is that fiscal policy is used as a complementary tool to achieve the economic desirable with the appropriate objectives designed. Sadly, however, in West African countries like Nigeria, Ghana, and the Gambia, successive governments have failed to realize the impact of fiscal policies due to uncontrolled wastages, funds misappropriations, lack of political will, nepotism, and overspending (ibid). (Fedoryshyna, 2020) sees fiscal policy as a potent tool for individuals and governments to play with. He holds the view that it would be better if fiscal policy have never been applied. Nonetheless, just as no nation will sit passively by letting a disease decimate its population, fiscal policy will always come into play in every country as soon as a slump begins to emerge. As a result, any government, whether aware of it or not, always pursues some form of fiscal policy. The fundamental question is whether this policy will be productive or unconscious and inconsistent. The neoclassical growth model holds that fiscal policy can only impact the level of output, not the long-run rate of growth, (Matallah, 2017). This means that fiscal policy may have an immediate influence on economic growth when the economy transitions from one steady-state equilibrium to another. Endogenous growth theories, on the other hand, argue that economic development is governed by endogenous variables such as physical and human capital accumulation, technological innovation, and government economic policy. Thus, these models tend to turn fiscal policy's transitory growth impacts into permanent effects by offering mechanisms via which fiscal policy variables may influence both the level of production and the steady-state growth rate, (ibid, p.126). In their study in 2014 to gauge fiscal policy's impact on the Ghanaian economy, (Havi & Enu, 2014) stressed fiscal policy as possessing an effect in the long term. They discovered that government investments and transfer payments had a beneficial impact on economic growth, but taxes and government consumption expenditures had a negative impact.

These, and other statements about fiscal policy's possibilities have prompted this review, the goal of which is to conduct a complete assessment of relevant literature to determine fiscal policy's role in Ghana's growth over the years. This research was carried out by conducting a systematic internet search utilizing a variety of terms such as fiscal policy, fiscal policy in Ghana, fiscal policy issues in Ghana, and fiscal policy challenges. Two main sources of information were examined to locate works with a specific focus on the issue in question: Google Scholar and ResearchGate.

Articles, books, reviews, conference papers, policy beliefs, and institutional working papers with the terms fiscal policy, economic policy, and Ghana in their names were used in this review.

As a result of this, only works published between 2000 and 2021 were consi-

dered for this study. It did not include books that were not published in English. Only papers from reputable institutions, journals, and authorities were considered for this review.

The first part of the work presents a general introduction; the second part captures conceptual clarification; the third part deals with the historical perspective about Ghana's fiscal policy journey; the fourth part performs an in-depth review on the role of fiscal policy in the development of the Ghanaian economy; the fifth part challenges with fiscal policy in the context of Ghana; while the sixth part contains the concluding remarks.

Conceptual Definition

The concept of fiscal policy dominates recent policy deliberations of most economies, especially about issues of economies and fiscal issues relating to employment, insufficient national savings, budget deficit among others, (Matallah, 2017). It encapsulates strategic efforts by governments in the areas of spending money and taxes to impact macroeconomic variables desirable, (ibid). An array of definitions exist for the concept in the economic literature. Fiscal policy is the manipulation of taxes and public spending to influence aggregate demand, (Fedoryshyna, 2020; Ogeh, Harvey, & Hagan, 2008). It captures an array of policy considerations. Fiscal policy captures an endless list of types of incomes for which the rules governing a tax regime could change, (Andrew & Harald, 2009). Ask any economist to explain the growing fortunes of any country and you are likely to be taken down the road of fiscal policy being a crucial determinant of growth, (Easterly & Rebelo, 1993). Over the decades, the deep-seated notion that taxes, public investment, and other components of fiscal policy create growth miracles as well as withstanding economic stagnation has been held within the realm of growth models, (ibid, p. 418). The entire assumption underpinning fiscal policy originates from the Latin word fiscalis which comes from fiscus, i.e. a basket used for collecting money, (Tanzi, 2006). Fisco in Italy means the agency responsible for tax collection. Therefore, "fiscal policy" means policy related to taxes. The Keynesian revolution has been accredited for the change in the meaning of the term fiscal policy to capture both revenue and spending, (ibid). With fiscal policy, an appreciation of the totality of measures taken by government bodies to change public spending and taxation is understood, (Fedoryshyna, 2020). Fiscal policy helps to smoothen fluctuations in the economic cycle, ensuring sustainable economic growth, achieving a high level of employment, reducing inflation. Depending on the focus, a government pursues either discretionary or automatic fiscal policy. The purposeful manipulation of government spending and taxation is referred to as discretionary. It is sometimes referred to as active fiscal policy. It may be done using both direct and indirect tools. The first is a shift in government purchase of goods and services, as well as transfer payments. The second is accelerated depreciation policy, which involves adjustments in taxes (tax rates, tax advantages, and tax base). It might be used as a technique for aggregate ex-

pansion during downturns. The reverse is true: it may be employed to slow down an economy if it is considered to be overheating, (Anaman et al., 2017). Noted by (M'Amanja & Morrissey, 2005) in (Anaman et al., 2017), fiscal policy can ensure the government's efficiency in resource allocation, market regulation, stabilize the economy amid the overall creation of social harmony for economic growth, and equitable distribution of income and wealth.

2. Ghana, Fiscal Policy & Economic Impact—A Historical Perspective

Fiscal policy has been a dominant feature of Ghana's economy since independence in the year 1957. Besides chalking significant surplus somewhere around the 1980s and 1990s, the country's fiscal policy has continuously resulted in deficits (Adu, 2017), contrary to expectations that the practice (fiscal policy) should curb fiscal deficit, which is caused by spending exceeding revenue leading to a potential rise in the rates of interest and inflation (Gyasi, 2020).

Consequently, this has hampered the gains of monetary policies over time (Quartey & Afful-Mensah, 2014).

Since 1996, the budget has never had a surplus; instead, it has been mired in deficits averaging 5.3 percent of GDP, much exceeding the looming West African Monetary Zone's convergence threshold of below 4 percent of GDP (WAMZ). Indeed, Ghana's higher budget deficits have been linked to less efficient government expenditure (purely recurrent), fiscal slippages during election years, and domestic and global economic shocks (ibid, p.5).

Ghana is asserted to have a long history of a limited fiscal capacity. During the colonial period, the country had one of the fastest expanding economies, but taxes, particularly on incomes, was underdeveloped (Broadberry & Gardner, 2019). The country has witnessed only 11 years of marginal budget surpluses since 1957 (averaging 1 percent surplus to GDP)—38 Revenues from taxes have frequently fallen short of projections (Aboagye & Hillbom, 2020). Between 1960 and 2014, the average government total revenue as a percentage of GDP was 16.3%, while government expenditure averaged around 19% of GDP. Even though government spending grows at a fast pace, economic development remained stagnant until 2011, when the government recorded an economic growth rate of roughly 14.5 percent, owing mostly to the commercial production of oil (Adu & Ishmael, 2015).

Ghana has grown at a 4.5 percent yearly rate since 1965, compared to an annual average growth rate of 8.5 percent in real expenditure. From 1995 through 2010, the economy grew at an average rate of 5.8%, rather than the 8% desired in vision 2020 projections. In the same years, real government spending increased by 13%. Ghana's budgetary record from 1970 to 1982 was extremely dismal.

Macroeconomic assessments and projections were not completed to provide a foundation for effective and consistent fiscal policy development throughout this time. Fiscal policy has played a critical role in the shaping of Ghana's govern-

ment agenda. This means that the levels of government spending and taxation are largely influenced by the government's objectives and ambitions (Kusi, 1998).

Sadly, Ghana's fiscal policy measures have been described as Adhoc, uncoordinated, and haphazardly implemented, leading to a severe deterioration in the country's public finances. A rapid growth in government expenditure accompanied by relatively low growth in revenue resulted in persistent budgetary deficits financed mainly by the banking system (ibid, p3). Since 1983, the tax system of Ghana has undergone a fundamental reform, aimed at improving revenue generation and maximizing the efficiency of collection. Tax reform has thus been used as an instrument for raising the revenue productivity of the tax system (Kusi, 1998).

Ghana's fiscal policies produced 22 years of deficits and eight years of surpluses between 1983 and 2012. During the 22 years, deficits averaged 5.0 percent of GDP, while surpluses averaged 0.8 percent of GDP. In terms of average GDP growth, however, the trends in output growth during these two decades did not differ significantly (Akosah, 2013).

3. Fiscal Policy Challenges for Emerging Economies like Ghana

The benefits of a perfect tax regime are well understood since it stimulates public investment in infrastructure, human capital, production, and institution support. Unfortunately, due to flaws in their tax regimes, many countries, particularly those in Sub-Saharan Africa, have yet to fully utilize these benefits.

Though the situation seems to have improved as a whole in the last decade. However, several cracks remain in the narrow tax base, underdeveloped financial markets, including remarkable deficiencies in governance and service delivery (Siebrits & Calitz, 2007).

Besides, scholars have identified administrative and technical challenges and Sub-Saharan Africa's weak economic structure as amongst the challenges confronting her fiscal policy regime (Aboagye & Hillbom, 2020).

Others claimed that the main problems may be traced back to colonialism's legacies. The many ways in which indigenous peoples were incorporated into the colonial system created an institutional and infrastructure legacy that continues to influence governments' tax policies and tax capacity.

The region is on record to have made significant gains fiscally in periods before the early 1980s, but had witnessed a decline in economic fortunes in the preceding twenty-five years-real GDP growth, declining from an annual average of 5.4 percent in the period 1960-1974 to 2.0 percent in the period 1975-1999; the corresponding average annual rates of growth of per capita GDP were 2.6 percent and −0.9 percent.

Growth in the sub-region as revealed had been hampered mainly by factors beyond the control of policymakers, including the small size of many countries, tropical climates, poor soils, erratic rainfall patterns, high levels of ethnolinguis-

tic diversity, long distances from industrial country markets, and heavy reliance on the exportation of a narrow range of commodities (many of which have been characterized by falling demand and volatile prices).

Also, available literature has highlighted the growth-stifling effects on policies that contributed to macroeconomic instability, such as excessive public sector activity and employment, poor service delivery, crowding out and suffocating regulation of private economic activity, highly protectionist trade regimes, overvalued exchange rate regimes, and discouragement of export production.

Furthermore, globalization has been one of the critical points for consideration. As a need for attracting foreign investment and as partial protection against the contagion effects of financial crises, globalization has necessitated the adoption of international best practices in fiscal policymaking (primarily matching the fiscal guidelines of the Washington consensus) (Siebrits & Calitz, 2007).

Globalization according to (Siebrits & Calitz, 2007) has curtailed the opportunity for economic policymaking independence. It makes adhering to the primary criterion of modest budget deficits more difficult. The greater worldwide mobility of tax bases puts downward pressure on tax rates, and trade liberalization frequently reduces governments' revenue from trade taxes. Globalization puts pressure on governments to boost public spending on infrastructure and social safety nets (especially to assist those who lose their jobs or capital because of increased exposure to foreign competition). In his opinion (Tanzi, 2000) globalization is likely to have a large and detrimental impact on countries' economies through their tax systems. 'Globalization', and the greater cross-border integration that comes with it, aided by rapid technological advancement, is likely to have an impact on a country's ability to collect taxes. It will also have an impact on how the tax burden is distributed. In the instance of an emerging economy like Ghana, issues of fiscal imbalance have limited the otherwise favorable projections about fiscal policy's outcomes.

The country's fiscal policy regime is fraught with ineptitude revenue mobilization capacity and poor public financial management systems. On the back of the impressive gains made after joining the IMF's HIPC initiative in 2000, which had seen Ghana reduce the overall level of fiscal deficit (cash basis) 9.81 percent of GDP in 2000 to 2.96 percent of GDP in 2005, amongst other impressive indicators including a three-decade low of 26% of GDP in 2006, Ghana's public debt to GDP ratio rose to 57.7% as at the end of 2013, only 2.3% below the IMF's critical debt threshold of 60% of GDP (Asiama, Akosah, & Owusu-Afriyie, 2014).

In a historical analysis of four major tax reforms in Ghana from the 1850s to the late 1990s, it was observed that taxation in Ghana has long depended on the ability of the state to convince taxpayers that tax revenues will be used for the public benefit. However, a history of misappropriation of tax revenues, overt corruption, and profligacy diminished taxpayers' support for governments' tax efforts (Aboagye & Hillbom, 2020).

4. Empirical Review of Fiscal Policy & Economic Development in Ghana

Through a variety of ways, fiscal policy can promote economic and human development. These include both macroeconomic and microeconomic factors (for example, the impact of the budget deficit on GDP) (through its influence on the efficiency of resource use) (Keen & Simone, 2004).

Empirical studies on the relationship between fiscal policy and economic growth in academia have yielded diverse results due to differences in countries. Different studies have attempted to demonstrate the impact of fiscal policy on economic growth (Gyasi, 2020). How has this panned out in the case of Ghana?

Ghana, like many other African countries, has experimented with a variety of strategies to achieve acceptable growth and development rates. With this goal in mind, various governments have pursued a variety of fiscal policies aimed at achieving a level of economic development that can be sustained (Ogeh, Harvey, & Hagan, 2008). This drive had been accelerated by heavy industrialization in the early 1960s, with a variety of control measures and state intervention.

The literature about the impact of fiscal policy on growth in Ghana has generated a large volume of empirical studies with mixed findings using cross-sectional, time series, and panel data (Ogeh, Harvey, & Hagan, 2008).

In a study, using time series data over the period 1983 to 2012 to analyze the influence of fiscal policy on Ghana's economic growth (20), it was discovered that government investments, government transfer payments, and tax income had a positive impact on the economy, however, government consumption had a negative impact.

This position has been corroborated by (Havi & Enu, 2014) in their 2004 study to gauge fiscal policy's impact on the Ghanaian economy. It was held that fiscal policy has an effect in the long term—noting that government investments and transfer payments had a beneficial impact on economic growth, but taxes and government consumption expenditures had a negative impact

The impact of capital expenditure was positive while recurrent expenditure had little impact on economic growth. Budget recurrent expenditure was found to have a high impact than capital expenditure on the growth of the economy.

In a study cited by (Ogeh, Harvey, & Hagan, 2008), using an autoregressive distributed lag (ARDL) model to examine the impact of fiscal policy on Ghana's economic growth from 1981 to 2008, it was revealed that fiscal variables had a long-run impact on economic growth.

Using the same model (ARDL), a study cited by (Gyasi, 2020), in an analysis of budget deficit and its effect on the economy concluded that democracy and public expenditure have no effect on growth in the long and short-run independently but rather had an effect when they interacted.

In an analysis of the impact of monetary and fiscal policies on Ghana's growth from 1980 to 2012, it was concluded that both boosted the country's growth. But, the study revealed that monetary policy is more powerful in promoting eco-

nomic growth in Ghana (Havi & Enu, 2014).

It was found in a 2015 study that in both the short and long run, government capital expenditure has a significant negative impact on economic growth but recurrent expenditure has a positive effect on economic growth in both the long run and the short run though it was not significant in the short-run (Adu & Ishmael, 2015), (Quartey & Afful-Mensah, 2014) discovered that budget balance and real stable economic growth are inversely associated, and that budget surplus (deficit) tends to hinder economic growth in Ghana.

In terms of components, tax revenue and recurrent expenditure were found to stifle long-run economic growth, whereas capital investment boosted it. Similarly, it has been discovered that rising public debt and its components reduce long-term economic growth.

As is the observation of the West African Monetary Zone (WAMZ) in its primary fiscal convergence criterion for member nations like Ghana, a deficit level below 4% of GDP would foster stable economic growth, but a deficit level above 4% would be detrimental to long-term economic growth. Since the Ghanaian economy is beset by deficits that exceed this threshold level, the necessary fiscal deficit restraint has been recommended.

5. Empirical Critique

This study took into account both qualitative and quantitative research on the impact of fiscal policy on Ghana's economic fortunes. Asiama et al. (2014) (Asiama, Akosah, & Owusu-Afriyie, 2014) offered information on Ghana's fiscal policy sustainability. They discovered that Ghana's budgetary adjustment looks to be quite low. Their findings indicated that significant fiscal pressure has persisted in recent years, owing mostly to fiscal excesses during election cycles.

In Ghana, government consumption expenditure had a considerable negative long-run influence on economic growth. (Promise Orlando Quashigah et al., 2014) found a unidirectional relationship between government consumption expenditure, government investment expenditure, transfer payments, tax revenue, and economic growth using the Granger causality test within the framework of cointegration and vector error correction models.

According to his assessment of the challenging decisions, Ghana's government faces difficulties in striking a balance between revenue-generating and expenditure targets. According to (Addison, 2001), state spending in Ghana has not been any more pro-poor in the recent decade than they were in the 1970s. They backed with findings that the country's budget deficit condition had worsened during the election season.

While suggesting an increase in revenue for the economy in order to achieve the continuous high growth required for poverty reduction, equity problems were highly emphasized. This is especially true considering that spending patterns do not appear to be directed toward poverty reduction.

According to Havi & Enu (2014), monetary and fiscal policies had a good im-

pact on the Ghanaian economy. However, it was discovered through their application of the Ordinary Least Squares estimate technique that monetary policy is more powerful in ensuring Ghana's economic growth.

In general, research concentrating on the role of fiscal policy in Ghana's economic history abound in the literature. However, not enough effort was taken in the sampled studies to understand how both monetary and fiscal policies may be balanced to achieve the desired long-term favorable economic impact. Future studies should concentrate on thoroughly evaluating both monetary and fiscal policies in order to avoid the recurring economic mistakes that have stifled the country's economic advances in the past.

6. Conclusion, Limitations & Recommendations

This paper reviewed the literature about fiscal policy and economic growth in the context of Ghana.

We found that the literature about the impact of fiscal policy on growth in Ghana has generated a large volume of empirical studies with mixed findings using cross-sectional, time series, and panel data. Government investments, government transfer payments, and tax income had a positive impact on the economy, however, government consumption had a negative impact.

This work is a novel syncretization of the corpus of studies about fiscal policy and its impact on Ghana's socio-economic growth. It has several contributions. First, this paper is a contribution to knowledge in the field. It, among other things, lays the groundwork for future research and serves as a reflection on how to improve the region's economic prospects.

It will create a firm foundation for advancing knowledge and facilitating future theory development. This is not an exhaustive review, however. In terms of the number of sources for sampling studies for the review, it is limited. Future research could build on this work by utilizing a wider range of data collection sources.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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