Educational Administration: Theory and Practice
2024, 30(4), 6725-6732
ISSN: 2148-2403
https://kuey.net/

Research Article

Educational Insights into the Political Business Cycles in Ghana: Empirical Overview from 1990-2020

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Citation: Donatus Ayitey.et al. (2024), Educational Insights into the Political Business Cycles in Ghana Empirical Overview from 1990-2020..., *Educational Administration: Theory And Practice*, *30*(4), 6725-6732
Doi:10.53555/kuey.v30i4.2470

Article Submission: 14 January, 2024, **Revised Submission:** 20 March, 2024, **Article Accepted:** 10 April, 2024

ARTICLE INFO

ABSTRACT

In view of the inability of incumbent governments to curb overspending in election years in the last three decades in Ghana and in the wake of COVID-19 pandemic in the 2020 elections where the government was determined to maintain some fiscal discipline but failed, there is a growing concern that excessive spending in election years could be counterproductive to the economic performance in the long and short runs. Going into election 2024 which is scheduled for December 07 in Ghana, this paper sets out to provide educational insights by ascertaining: (1) evidence of political business cycle in Ghana, and (2) the implications of loose monetary and fiscal choices in election years on economic performance within the context of Autoregression modeling framework and time series data from 1990-2020. One insight is that, the error correction results provide evidence of political business cycles driven by excessive spending which negatively affect the economy in the short-run. Another insight is that, Cointegration analysis points to loose fiscal and monetary habits in election years that do have negative long- and short- run implications for economic performance. In fact, results show that, holding other factors constant, 1 percent increase in budget deficits in election years significantly decreases the rate of GDP growth by 0.23 and 0.49 percent in the long- and short-runs respectively. Another finding is that, the growing national debt and exchange rate volatility have negative effects on economic performance. While, 1 percent increase in national debt driven by overspending in election years decreases the rate of GDP growth by 0.15 percent, 1 percent increase in the rate of cedi depreciation decreases the rate of GDP growth by 0.40 percent in the long run respectively, all things being equal. Based on these insights, the paper therefore recommends strict adherence to fiscal responsibility law enacted in 2018 and other policies aimed at ensuring prudent fiscal and monetary decisions in election periods.

Keywords: Political business cycles; fiscal discipline; economic performance; Ghana

1.0 Introduction

Ahead of the 2020 elections in Ghana, some economic commentators started wondering whether government could maintain fiscal discipline as promised since successive governments were not able to stick to their election years' fiscal and monetary targets in the last three decades. For example, articles with captions such as "*Kicking the Spending Habit: Can Ghana Resist Overspending Ahead of Elections in 2020? Unlikely*[1]" and

[1] See: https://www.songhaiadvisory.com/blog/2019/10/18/kicking-the-spending-habit-can-ghana-resist-overspending-ahead-of-elections-in-2020-unlikely

"*Will procyclicality override Ghana's new fiscal responsibility law?*"[2] demonstrate genuine concern from the public. It was not surprising therefore that budget deficits which were expected not to exceed 5% ballooned to 11.4% in election year in 2020. Actually, one of the most difficult policy issues confronting monetary authorities in many developing economies is excessive spending in the election years. Inability to curb spending in election years has led to huge budget deficits which add to existing national debt. Huge national debt could create uncertainty, lower investment, and raise costs of doing business, thus lowering rates of growth.
This paper relied on autoregression modeling framework to provide some educational insights by assessing the effects of political business cycles associated with loose fiscal and monetary shocks on economic performance using Time series data from 1990-2020.

2.0 Brief review of theoretical and empirical literature

2.1 Theoretical underpinnings
The concept of political business cycle is based on the notion that certain macroeconomic variables such as money supply, inflation, budget deficits, output and unemployment are induced by the electoral cycles (Nordhaus 1975). Since Nordhaus paper in 1975 which raised the issue of the political business cycle, several theories have come up. In opportunistic business cycle theory, cycles are induced by incumbent government's making certain economic choices in election years to achieve their parochial interest of winning reelection but these decisions may actually be counterproductive to the economy going forward. In partisan political business cycle theories, the cycles are driven by parties' ideologies where each party's economic path reflects what they believe in, be it liberal or right wing thinking (Hibbs, 1977).
In theory, incumbent governments especially in developing countries often seek to boost economic performance before and during election years to increase their chances of reelection. This normally leads to loose monetary and fiscal policy stance in the form of expansion of money supply, inflation, debt and budget deficits in election periods with some of their own economic targets being missed. While excessive spending in the election years can lead to a rise in aggregate demand and economic growth in the short-run, it can also have serious implications for economic growth if the spending is not channeled into productive sectors.

2.2 Empirical review

According to Alesina, Cohen, and Roubini (1992), empirical studies on political business cycles can be put into two broad categories. The first category of studies which focused on testing political business cycle hypothesis using policy outcomes such as output growth, unemployment, and inflation overwhelmingly rejected the hypothesis. The second category of studies which focused on testing political business cycle hypothesis using policy instruments such as money growth, taxes, transfers and government spending yielded mixed outcomes. For example, a study by Iddrisu and Bokpin (2017) which sought to understand the incidence and the impact of the African political business cycle in 39 African countries using panel regression techniques with data from 1990 to 2014 found political business cycle to be present in Africa and that such cycles do not translate to economic performance. In furtherance to this, a recent study by Obakemi et al. (2021) sought to investigate the link between political business cycle and fiscal discipline in Sub-Saharan Africa using data sourced from thirty-six (36) countries between 1990 and 2018. Results from the Generalized Methods of Moment (GMM) showed that fiscal deficit was significantly large in election years with spillover effects in the year after election. Thus, in order to maintain sustained fiscal health, the study advocated for policies to end the persistent deficits in Sub-Saharan Africa.
Another study by Nkrumah et al. (2016) which relied on Autoregressive Distributed Lag approach with trend analysis to assess the relationship between Ghana's budget deficit and economic growth from 2000 to 2015 using quarterly data found a significantly negative effect of budget deficits on economic growth in the long-run. In a related study, Anaman and Bukari (2019) examined macroeconomic impact of national elections in Ghana. Using data covering period 1992 to 2016. Results from the study revealed that elections and associated increase in public expenditure significantly produced higher levels of inflation and interest rates. The situation hurt the average Ghanaian and businesses due to effects of high inflation and borrowing costs (interest rates) on businesses. Though, the revelations from the study sounds appealing, specific recommendations to address the findings are not clearly articulated in the study.

A study by Enu and Okonkwo (2015) sought to investigate political business cycle and its effects on the Ghanaian economy. Using data from 1990 to 2013; the Ordinary Least squares estimation revealed that there was no significant impact of election years on the changes in government consumption expenditure, fiscal deficit and real GDP in Ghana. This notwithstanding, the study found government consumption expenditure and fiscal deficit to have positive relationship with election years in Ghana. Thus, suggesting the need for governments to ensure more fiscal discipline in election years. However, the effectiveness of a recommendation that there should be check and control of political parties' financing provokes further investigation to ascertain this.

[2] World Bank 2019 authored by Michael Geiger and Arthur Mendes: See;
https://blogs.worldbank.org/africacan/will-procyclicality-override-ghanas-new-fiscal-responsibility-law

2.3 Recent developments to ensure fiscal discipline in Ghana

With the aim to ensure fiscal discipline, a number of actions have been taken. For example, in 2016, Parliament passed the Public Financial Management Act (Act 921) to promote prudent management and control of public funds, assets, liabilities and resources. Since then, further steps have been taken to enact the Fiscal Responsibility Act in December 2018. The Act caps the annual fiscal deficit at 5 percent of GDP which the government promised to meet but failed in 2020 elections due to COVID-19 pandemic and shortfall in domestic revenue. The rule which caps fiscal deficit at 5 percent of GDP has currently been suspended due to the need to hike spending to stimulate the economy in the wake of the pandemic. Also, Presidential Advisory Fiscal Council and the Financial Stability Council were instituted in December 2018 to keep government finances in check and to also help sanitize the financial sector (MOFEP, 2018)[3].

3. Objectives of the Study

The general objective of this study is to investigate the effects political business cycles associated with loose fiscal and monetary choices on economic performance. The specific objectives are to investigate:

1. Any evidence of political business cycle in Ghana.
2. The implications of loose monetary and fiscal choices in election years on economic performance.

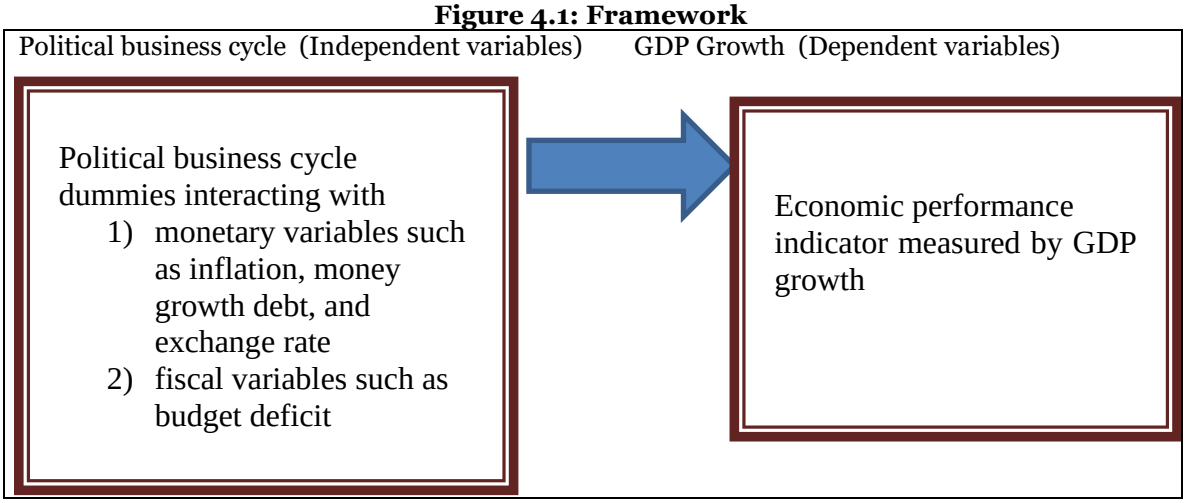
3.1 Hypotheses

1. The null hypothesis (Ho): no evidence of political business cycle in Ghana versus the alternative hypothesis (Ha) of evidence of political business cycle in Ghana;
2. The null hypothesis (Ho): Loose monetary and fiscal choices in election years have no effect on economic performance versus the alternative hypothesis (Ha) that loose monetary and fiscal choices in election years have effect on economic performance.

4.0 Empirical framework, data and methodology

To achieve the study objectives, we relied on Autoregression modeling framework which regresses an economic performance indicator measured by GDP growth on itself and political business dummies interacting with a set of independent variables (Figure 4, 1).

Figure 4.1: Framework



In all, these indicators are defined as:

- GDP growth= economic performance indicator (annual %)
- Inflation= consumer prices (annual %)
- Money growth= Broad money growth (annual %)
- Budget deficit= General government revenue minus expenditure (in billions of GHS)
- Debt stock= General government gross debt (% of GDP)
- RER= Official exchange rate (LCU per US$, period average)

[3] MOFEP (2019). FISCAL RISK STATEMENT 2018. https://www.mofep.gov.gh/sites/default/files/reports/economic/2018-Fiscal-Risk-Statement.pdf
Alesina, Alberto, Gerald D. Cohen, and Nouriel Roubini. 1992.Macroeconomic policy and elections in OECD democracies. Economics & Politics 4(1): 1-30. https://dash.harvard.edu/bitstream/handle/1/4553023/dalesina_macroeconomicoecd.pdf

- PBC= Political business cycles dummies (assuming 1 in election year and 0 otherwise).

4.1 Data sources

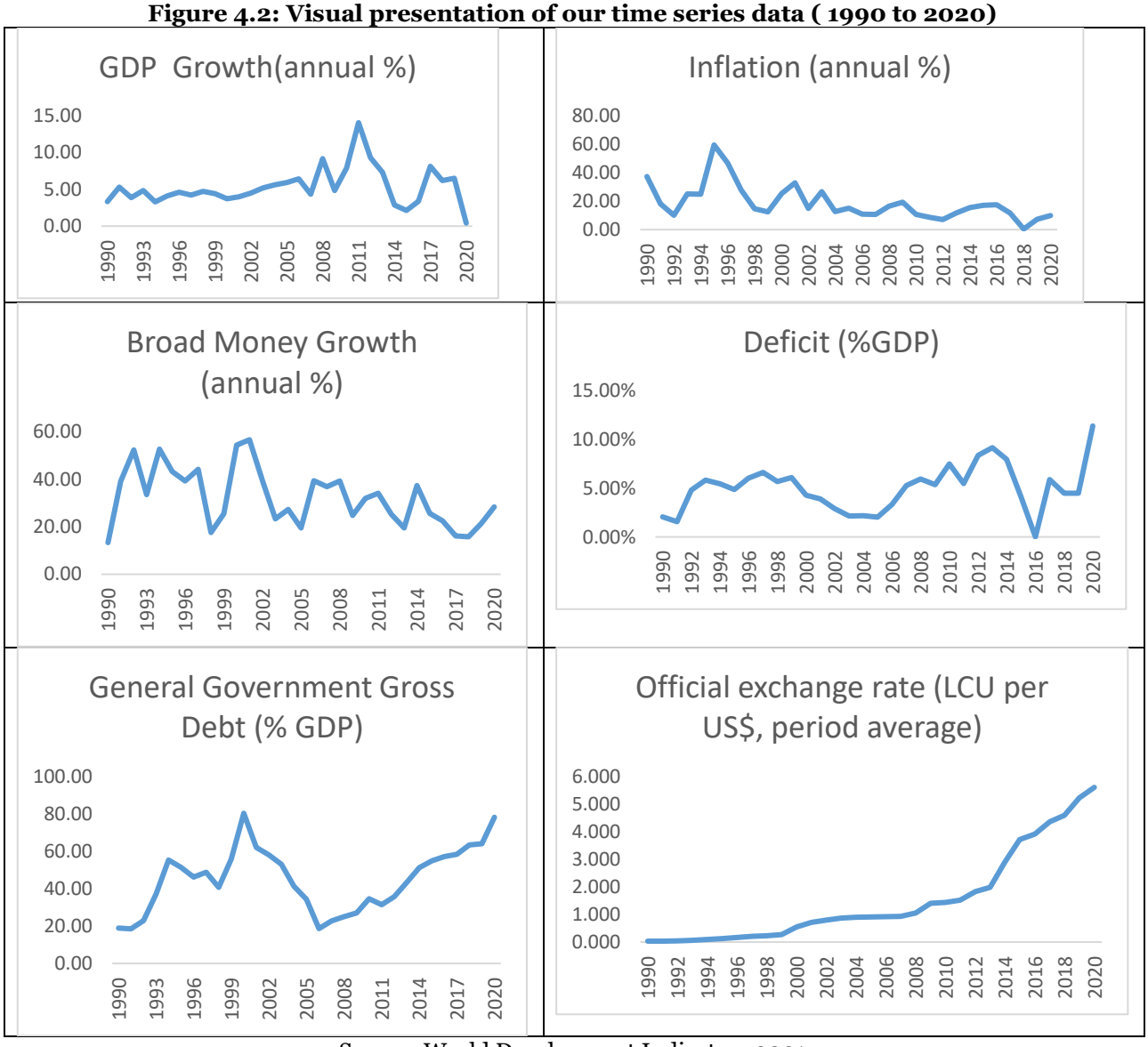
The study relied on Time series data (1990-2020) to understand the effects of political business cycles associated with loose fiscal and monetary choices on economic performance. Data were obtained from these sources:

- Bank of Ghana Annual reports, various issues.
- Quarterly Digest of Ghana Statistical Service, various issues.
- The State of the Ghanaian Economy, various issues.
- World Bank (2005), World Development Indicators, Washington D.C., USA
- International Monetary Fund 2020 and Country Economy[4] websites

3.1.1 Are there time trends, co-movements and structural breaks in our data?

To answer this question, we relied on visual presentation of our time series data to identify any time trends, co-movements and structural breaks, we plot our variables against time (Figure 4.2). Our plots suggest the presence of time trends, co-movements between variables and structural breaks in GDP growth, inflation, broad money growth, budget deficit, general government gross debt and official exchange rate.

Figure 4.2: Visual presentation of our time series data (1990 to 2020)



Source: World Development Indicators 2021

[4] https://countryeconomy.com/deficit/ghana

4.2 Methodology

This analysis is based on time series methodological techniques. To determine whether it is long- or short-run model that best fits the data, we test for the stationarity of our time series variables. The requirement is that, stationarity be established in the time series variables. Here, we applied Dickey and Fuller (1979, 1981) procedure to formally test for the presence of a unit root to know whether: 1) variables are non-stationary in levels, and 2) stationary after first differences or not. We also checked for the stationarity in the residuals from the model estimated to know whether GDP growth and other variables are cointegrated or have long-run equilibrium relationships.

Stationarity stipulates that statistical descriptors of the time series are invariant for different ranges of the series. Weak stationarity assumes only that the mean and variance are invariant. Strict stationarity also requires that the series is normally distributed. Since our variables are 1) non-stationary in levels, and 2) stationary after first differences, we conclude that they are cointegrated (Figure 4.3). Further checks on the integration of GDP growth and Debt stock as well as exchange rate show that their residuals are stationary as they appear not to be stationary after first differencing (Figure 4.3).

4.2.1 Choosing the Lag Length for the ADF Test

Augmented Dickey-Fuller (ADF) procedure tests for the null hypothesis of a stochastic trend (non-stationary) against the alternative of a deterministic trend (stationary). The model is specified as:

$$\Delta y_t = \psi^* y_{t-1} + \sum_{i=1}^{p-1} \Psi_i \Delta y_{t-i} + \mu + \gamma t + \mu_t \qquad \mu_t \sim \text{IID}(0, \sigma^2)$$

Implementation of the ADF test (Figure 4.3) requires the specification of the lag length p. If p is too small then the remaining serial correlation in the errors will bias the test. If p is too large then the power of the test will suffer. In this paper, we selected lag-length using the model selection procedure that tests to see if an additional lag is significant or increases the value of $\overline{R}^2$. Results from Augmented Dickey-Fuller and Cointegration tests in Figure 4.3 indicate that Money Growth and GDP Growth were stationary after first differencing and including two lags suggesting that Money Growth and GDP Growth may follow a process that is adequately captured by an autoregressive model with two lags. This implies that the current values of the Money Growth and GDP Growth depend on their past values up to two periods ago, and any shocks or innovations to the series were quickly absorbed. CPI was stationary after first differencing and including four lags. This implies that the current value of CPI depends on its past values up to four periods ago, and any shocks or innovations to the series were quickly absorbed. For deficit, there was stationarity after first differencing and including two lags. Results also show cointegration relationships between GDP growth and Debt stock as well as Exchange rate.

Figure 4.3: Results from Augmented Dickey-Fuller and Cointegration Tests

	Money Growth	GDP Growth	ΔMoney Growth	ΔGDP Growth
tau-stat	-2.391	-2.811	-4.228	-3.667
tau-crit	-2.961	-2.961	-2.964	-2.964
stationary	**no**	**no**	**yes**	**Yes**
aic	7.783	4.805	7.992	5.064
bic	7.973	4.995	8.184	5.256
lags	2	2	2	2
coeff	-0.610	-0.724	-1.843	-1.725
p-value	> .1	0.0719	< .01	0.0101
	CPI	GDP Growth	ΔCPI	ΔGDP Growth
tau-stat	-0.766	-1.464	-5.551	-3.955
tau-crit	-2.960	-2.960	-2.964	-2.964
stationary	**no**	**no**	**yes**	**Yes**
aic	7.396	4.921	6.805	5.011987
bic	7.687	5.212	7.098	5.304517
lags	4	4	4	4
coeff	-0.172	-0.506	-2.948	-3.147
p-value	> .1	> .1	< .01	< .01
	Deficit	GDP Growth	ΔDeficit	ΔGDP
tau-stat	-3.427	-2.699	-5.048	-3.616
tau-crit	-3.551	-3.551	-3.556	-3.556
stationary	**no**	**no**	**yes**	**Yes**
aic	-0.538	4.861	-0.179	5.118

bic	-0.3009	5.099	0.060	5.358
lags	2	2	2	2
coeff	-1.417	-0.807	-2.679	-1.722
p-value	0.068	> .1	< .01	0.0455
	Debt stock	GDP growth	ΔDebt stock	ΔGDP Growth
tau-stat	2.400	-2.810	3.121	-3.667
tau-crit	-2.960	-2.960	-2.964	-2.964
stationary	**no**	**no**	**no***	**yes**
aic	6.364	4.804	6.626	5.064
bic	6.555	4.994	6.818	5.256
lags	2	2	2	2
coeff	0.218	-0.724	0.4811	-1.724
p-value	> .1	0.071	> .1	0.010
	Exchange rate	GDP growth	Δ Exchange rate	ΔGDP Growth
tau-stat	1.899	-2.810	-1.489	-3.667
tau-crit	-2.960	-2.96	-2.964	-2.964
stationary	**no**	**no**	**no***	**Yes**
aic	-0.180	4.804	-0.026	5.064
bic	0.009	4.994	0.165	5.256
lags	2	2	2	2
coeff	0.082	-0.724	-0.342	-1.724
p-value	> .1	0.071	> .1	0.010

*Further checks show cointegration relationships between GDP growth and Debt stock & Exchange rate

4.3 Autoregression model

Following from works done by Alesina, Cohen, and Roubini (1992), we test the existence of a political cycle by running an Autoregression of our dependent variable GDP growth on itself and a set of dependent variables interacting with political business cycle dummies (PBC), that is, a regression equation 1:

$$GDP_t = \sum_{i=1}^{s} a_i\, GDP_{t-1} + b_0 + \sum_{j=1}^{l} b_j\, X_{jt} + c[PBC * X_{jt}]_t + \varepsilon_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots 1$$

where GDP_t is a proxy for economic performance and the X_{jt} are independent variables defined in section 4.0 and the interactive effects of political business cycle dummies independent variables.
We modeled interactive effects of political business cycle dummies as independent variables on economic performance as in equation.

In the short run model, equation 1 is estimated in first difference with the residuals of cointegration regression added as error-correction term. The model is specified as:

$$\Delta GDP_t = \sum_{i=1}^{s} a_i\, \Delta GDP_{t-1} + b_0 + \sum_{j=1}^{l} b_j\, \Delta X_{jt} + c[PDUM * X_{jt}]$$

$$+ \boldsymbol{ECM}_{\boldsymbol{t-1}} + \varepsilon_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots 2$$

Where $\boldsymbol{ECM}_{\boldsymbol{t-1}}$ is an error-correction factor and ε_t is the serially uncorrelated error term.
To obtain coefficients of elasticities, we worked with the logs of dependent and independent variables.

5.0 Empirical Analysis

5.1: Long-run effects: Political business cycle effects on economic performance

Table 5.1 presents the estimated results of the Autoregression equation (1) showing long-run relationship between the dependent variable (GDP growth) and independent variables as interactive effects of political business cycle dummy and budget deficit (PBC*BD), inflation PBC*INF), money growth (PBC*MG), Debt (PBC*DS) and exchange rate (PBC*ER). The coefficients of the variables are the elasticities because the logs of the variables were estimated. The signs of the variables, the statistical significance and the magnitudes involved in the cointegrating relationship are extremely important and need to be carefully analyzed. The signs of the estimated coefficients of interest are in accordance with what intuition would suggests. Specifically, the interactive effects of budget deficit shown as PBC*Log(BDF), inflation (PBC*Log(INF)t-2), money growth

(PBC*Log(MG)t-2), Debt (PBC*Log(Debt)t-2) and exchange rate (PBC*Log(ER)t-2) all have negative relationship with GDP growth (Log(GDPt)) in the long-run.
While the effects of inflation and money growth were not statistically significant, that of budget deficit, debt and exchange rate were. Expressly, results show that 1 percent increase in budget deficits in election years significantly decreases the rate of GDP growth by 0.23 percent in the long run holding other variables constant. Results also indicate that the growing national debt and exchange rate volatility have negative effects on economic performance as 1 percent increase in national debt driven by overspending in election years and 1 percent increase in the rate of cedi depreciation decrease the rate of GDP growth by 0.15 and 0.40 percent in the long run respectively, all things being equal. These findings reject null hypothesis of no evidence of political business cycle in Ghana in favour of the alternative that there is evidence of political business cycle in Ghana which is counterproductive to growth performance in the long-run.

Table 5.1: Dependent variable: Economic performance measured as Log(GDPt)

	(1)	(2)	(3)	(4)	(5)
Intercept	0.76** (0.2827)	0.75** (0.2788)	2.34** (0.2589)	0.70** (0.2579)	0.64** (0.2626)
Log(GDPt-1)	0.37 (0.3372)	0.39 (0.3348)	0.44 (0.3057)	0.41 (0.3104)	0.40 (0.3116)
PBC*Log(INF)t-2	-0.05 (0.0955)				
PBC*Log(MG)t-2		-0.05 (0.0768)	-0.23** (0.0983)		
PBC*Log(BDF)t-2				-0.15** (0.0719)	
PBC*Log(Debt)t-2					
PBC*Log(ER)t-2					-0.40** {0.1958}

Note: Estimated regression includes other lag effects of GDP which are not reported
Number of observations is 28
Standard errors are in parentheses
***Significant at 1%; **Significant at 5%; *Significant at 10%

The cointegration long-run estimates confirm earlier studies by Iddrisu and Bokpin (2018) which found political business cycle to be present in Africa. It also corroborates Nkrumah et al. (2016) work which relied on Autoregressive Distributed Lag approach with trend analysis to assess the relationship between Ghana's budget deficit and economic growth from 2000 to 2015 using quarterly data. The only difference is that, while their study captured the effects of budget deficit on economic growth in general, this study focused on the overspending in election years on economic performance over three decades.

5.2: Short-run effects: Political business cycle effects on economic performance

Table 5.2 presents the estimated results of the Autoregression equation (2). The error correction term, which indicates the speed with which adjustment to the long run equilibrium occurs in the rate of GDP growth is 59% , 59% , 54% 55% and 52% in models (1), (2), (3), (4) and (5) respectively. The negative sign and statistically significant coefficients show the existence of equilibrium relationship.

Table 5.2: Dependent variable: Economic performance measured as ΔLog(GDPt)

	(1)	(2)	(3)	(4)	(5)
Intercept	-0.02 (0.0250)	-0.02 (0.0256)	0.003 (0.0284)	-0.004 (0.0288)	-0.02 (0.0292)
ΔLog(GDPt-1)	0.26 (0.1840)	0.26 (0.1854)	0.37** (0.1803)	0.32* (0.1875)	0.33* (0.1931)
ΔPBC*ΔLog(INF)t-1	0.14 (0.2585)				
PBC*ΔLog(MG)t-1		0.12 (0.3627)			
PBC*ΔLog(BDF)t-1			-0.49* (0.2612)		
PBC*ΔLog(Debt)t-1				-0.52 (0.4012)	
PBC*ΔLog(ER)t-1					0.27 {0.4468}
ECMt-1	-0.59*** (0.1598)	-0.59*** (0.1630)	-0.54*** (0.1668)	-0.55*** (0.1836)	-0.52*** (0.1787)

Note: Estimated regression includes other lag effects of GDP which are not reported
Number of observations is 28

Standard errors are in parentheses
***Significant at 1%; **Significant at 5%; *Significant at 10%

Of our variables of interest, which are the interactive effects of budget deficit (PBC*Log(BDF), inflation (PBC*Log(INF)t-2), money growth (PBC*Log(MG)t-2), Debt (PBC*Log(Debt)t-2) and exchange rate (PBC*Log(ER)t-2) on GDP growth (Log(GDPt)) , only the interactive effects of budget deficit had negative and significant effect on GDP growth in the short run confirming the hypothesis that excessive spending in election years would be counterproductive to the economic performance even in the short run. This indicates that any increase in budget deficit by 1% decreases the rate of GDP growth by 0.49% in the short run, ceteris paribus.

6.0 Conclusion

This paper sets out to provide some educational insights by ascertaining: (1) evidence of political business cycle in Ghana, and (2) the implications of loose monetary and fiscal choices in election years on economic performance. The paper relied on Autoregression modeling framework to answer the questions using time series data from 1990-2020. The first insight is that Cointegration analysis suggests evidence of political business cycle in Ghana and that loose fiscal and monetary habits in election years do have negative long- and short- run implications for economic performance. The second insight is that, the error correction results provide evidence of political business cycles driven by excessive spending which negatively affect the economy in the short-run. The paper therefore recommends strict adherence to fiscal responsibility law enacted in 2018 and other policies aimed at ensuring prudent fiscal and monetary decisions in election periods.

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