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Anatomizing Inflation In Ghana: The Major Cause of Ghana's Inflation

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Abstract
Money serve significant economic functions which loses its real value when affected by the lethal disease of inflation. More often governments and policy makers are blinded with a false dichotomy: inflation or unemployment which is an illusion. The major dilemma is whether we have higher unemployment as a result of higher inflation or is it an impermanent side effect of rectifying inflation? In this paper, the central origin of inflation have been identified as a monetary phenomenon. The paper also extends to expand on why citizens of Ghana rationally switched to the dollar, including inflation trends in Ghana. More pertinently in this contextual analysis is the explanation on how the supply of money determines the price level. As John Stuart Mill wrote a century ago: "There cannot, in short, be intrinsically a more significant thing in the economy of society, than money; except in the character of a contrivance for sparing time and labour. It is a machine for doing things quickly and commodiously, without it: and like many other kinds of machinery, it only exerts a distinct and independent influence of its own when it gets out of order", the currency of a nation plays vital roles to its economic prosperity and this is why it seems reasonable to analyze inflation (a fatal disease to the value of money) to present concrete remedies.

Keyword: *Anatomizing Inflation, Cause of Inflation, Inflation in Ghana*

I. WHY THE GHANA INFLATION BROUHAHA?

Inflation is deleterious and precarious to every economy and governments around the globe make unremitting efforts to address the menace of inflation. Inflation contributed to the overthrow of Allende in Chile in 1973, the defeat of Chairman Mao of Chiang Kai-Shak in China, military intervention in Brazilian government in 1954 among many others. Inflation is imputed to be due to many causes and governments become reluctant to accept responsibilities for the causes of inflation, developing dismal excuses to inflation issues. One major reason why inflation is so destructive is because it separates society into winners and losers where others gain at the expense of others. Inflation occurs generally when the quantity of money rises appreciably precipitously than output. What then is inflation? Inflation is the persistent increase in prices of goods and services because the demand for goods and services outweighs the supply. Gregory Mankiw a renowned economist maintained that "inflation is the increase in the overall level of prices" (Mankiw, 2010). Mostly, economists measure inflation as the percentage change in the overall price level using the CPI, GDP Deflator or some other index measure. The types of inflation normally are creeping inflation, suppressed inflation and hyperinflation. The inflation in Ghana can be described as suppressed inflation due to the level of rising prices which can be brought under control through price controls, rationing, monetary and fiscal policies. Inflation generally reduces the value of money. It is blatant in this regard that the high inflation rates of Ghana has retrogressed savings. Most people in Ghana resorted to the use of other foreign currencies due to the incessant decline of the value of the cedi caused by inflation. This paper attempts to explain that, inflation is a monetary phenomenon especially in Ghana.

II. WHY DID CITIZENS SWITCH TO THE DOLLAR?

In the wake of rising prices and falling value of the cedi, citizens rationally switched to a more stable currency (the dollar). The central bank retaliated with policies to keep citizens from using the dollar. The question is, should citizens be blamed for buying more dollars? One of the functions of money is the measure of value. This means, money that enables us to assess the relative value of goods and services. The indicator of value is price. When we express our opinion as something being extortionate or cheap, it is the price that enables us to make such assessment. The price of a product or service is its economic value and the currency of a country can be taken to be a commodity whose value can upsurge or plummet. The value of money is susceptible to erratic prices. When prices are stable, they have a corresponding stable effect on the value of money (the cedi). The value of money deteriorates as a result of inflation. The price hikes in the economy compelled citizens to demand more foreign currencies at the expense of the cedi. Citizens demanded more foreign currencies (especially the dollar) because the actual quantity of goods and services that the cedi could afford was infinitesimal.

Moreover, citizens of Ghana diverted to the use of other currencies consequent to unequal distribution of income. The inflation of Ghana caused fixed wages earners, creditors and fixed interest securities holders to lose against non-fixed income earners like debtors. More critically, during the inflationary period, the rate of interest was fixed which did not skyrocket proportionally to the rise in the price level. This precipitated the fall in savings because of the fall in value of the cedi.

In addition to this, citizens were bedeviled with high cost of living beyond normal comprehension. The inflationary situation coerced citizens to expend more financial resources to purchase the same goods and services consumed

previously. This unduly exorbitant inimical cost of living incited workers to embark on incessant demonstrations and strikes to back their demand with high wages due to the increasing cost of living and falling standard of living.
An overview of inflation in Ghana shows that inflation movement is fitful. The highest and outrageous rate was in 1983 when inflation rate rose to 122.875% shown by the figure above with the lowest figure experienced in 2011 at a rate of 8.7% (a change of -9291.96 basis points from 1983 to 2011). The inflation of Ghana over the years fluctuated helplessly which has led to some critical opprobrium from analysts. In the year between 2011 and 2012, inflation rate of Ghana was recorded at a single digit of 8.7% and 9.2% respectively. Also inflation rate was recorded at a high rate in 1981 and 1983 at a rate of 116.504% and 122.875% respectively. What accounted for this dissimilar rates? Analysts in Ghana have expressed diverse views over the genesis of the inflation catastrophe.

Low productivity is one common explanation for the inflation in Ghana. It is crystal clear and acceptable that low productivity causes aggregate supply to be less than aggregate demand causing higher prices. This is veracious enough but what matters for the level of inflation is the quantity of money per unit of output. Low productivity is part of the problem but the central origin of the problem is the excessive supply of money.Also, governments argue that increase in wages and salaries is a cause of their inflation. This is acceptable based on the view that, when workers agitate for increase in wages and salaries and it is granted, it will increase the cost of production of producers who will in turn pass the increase in cost of production to consumers in the form of higher prices. This assertion is another minor cause of inflation in countries but the brutal wave of the causal factor is monetary growth.

More significantly is the axiom of imported inflation. Some analysts propose that, where goods and services are being imported from a country that is experiencing inflation, the higher prices will be transferred to the country importing. This explanation that inflation is imported is only cogent when the various currencies of countries were linked together through the gold standard. In that sense, inflation was affected by imports because numerous countries used the same commodity as money and in that situation, anything that affected the quantity of money of one country has the high tendency to affect another country. However, in this modern era, imported inflation explanation no longer holds as different countries have different currencies. If it does, then why will a country like Ghana have a different inflation rate from that of Canada for instance? Inflation is more of a country's economic issues and the officials of a country have the ability to control their inflation. Hence inflation of a country is more affected by endogenous parameters than exogenous parameters.

Inflation causes a lot of distortions to the fabric of society. On the other hand, inflation has had its positives argued by most government officials. Analysts accept and claim that inflation tend to lead to low unemployment. This concept which is substantiated by the Philips curve is mostly accepted for political propaganda. This is true but does it work for all countries in all cases? This concept of the Philips curve does not work in countries with weak institutions and interruptions in the price mechanisms.

Inflation produces revenue for government by automatically raising effective tax rates. When peoples' income rises with inflation, their incomes is taxed at a higher rate. When people s' income rise to match the percentage of inflation, the government tax revenue tends to rise. This is why politicians and governments must find a way to cut the taxes of Ghanaians.

Also, inflation tends to yield revenue for government in the cause of paying off debts. The government of Ghana borrows in dollars and pays back in dollars. Due to inflation, the government benefits when it has to pay back. However, inflation will not be of benefit to government if it had already paid enough rate of interest on debts to compensate creditors for inflation.

III. REAL OR MAJOR CAUSE OF INFLATION IN GHANA

Inflation has been ascribed to be due to many factors. Others argue that inflation is a Capitalist, Communist or Socialist phenomenon among many other factors. According to Armah 2014, inflation is caused mainly by printing of money by the Bank of Ghana (BOG). Also, he maintained that since the BOG does not have its autonomy, and as such it fails to resist undue pressures from the executive especially with the printing of money to finance government projects.
Again, Japan's experience in the 1971 indicates that inflation is more of a monetary phenomenon. From 1971, the quantity of money in Japan was growing at a higher rate and by mid-1973, it was growing more than 25% a year. Though there was no rise in inflation immediately, prices rose early in 1973 which prompted policy makers to change monetary policies. Monetary policy was quickly reduced from 25% a year to between 10% and 15% for five years. After about 18 months of reduction in monetary growth, there was a contraction in inflation, but it took two and a half years before reaching a single digit. Inflation turned rapidly towards zero due to fall in monetary growth (Friedman, 1980). It must be emphasized that inflation is due to the avalanche supply of money in an economy by printing more

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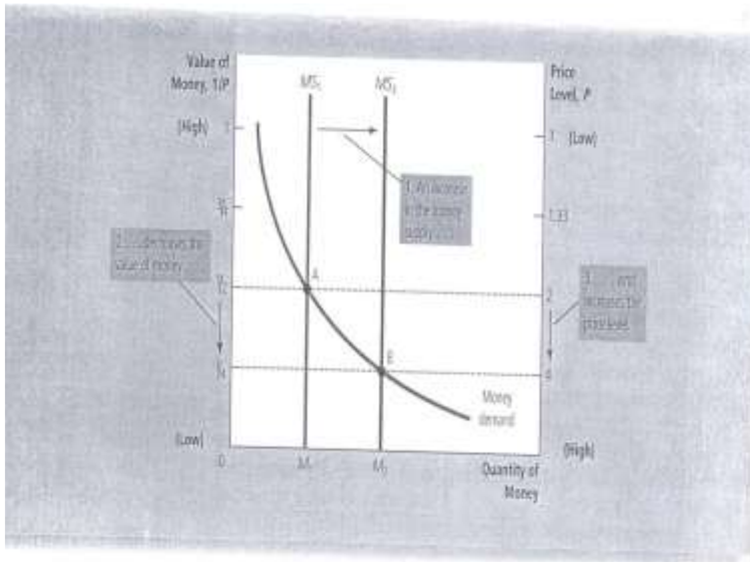
currencies. The recent experience of Zimbabwe attests to this analogy. Milton Friedman, a Nobel Prize Economist accentuated that "inflation is a monetary phenomenon arising from more rapid increase in the quantity of money than output". Often governments have been misled by a false dichotomy that inflation or unemployment. This option is an illusion, as inflation can be controlled to a zero percent level. Countries like Montenegro, Bulgaria and Portugal have negative inflation rates at -1.2%. -1% and -0.9% respectively as at July 2014 (CIA World Factbook, 2014). The quantity theory of money also states that "the quantity of money available determines the price level and the growth rates in the quantity of money available determines the inflation rate" (Mankiw, 2010).

IV. HOW THE SUPPLY OF MONEY DETERMINES THE PRICE LEVEL



Source: ***Principles of Macroeconomics*** **6th Edition (Mankiw,2012)**

From the diagram above, the left vertical axis shows the value of money and the right vertical axis shows the price level. The demand curve is downward sloping because we assume people hold less money when the value of the cedi can buy less. That is why inflation leads to a fall in savings. The horizontal axis shows the quantity of money. At point 'A' indicates the equilibrium level where the value of money and the price level have adjusted to bring the quantity of money supplied and demanded into balance. When the Bank of Ghana increases the monetary supply, the curve shifts from Ms1 to Ms2. The equilibrium also moves from point A to point B. This indicates that the supply of money makes more money available in the economy increasing the price level and making the cedi less valuable. This indicates that the supply of money by the Bank of Ghana is not a healthy policy to raise revenue for government. The government and its officials should find a way of mobilizing revenue for development instead of exerting undue pressure on the Central Bank to print more money. Milton Friedman reiterated "inflation is always and everywhere a monetary phenomenon"

V. KEY QUESTIONS

Inflation has its positives and negatives on every economy but high inflation rate will not produce better outcomes for countries. Moreover, most people tend to enjoy inflation in Ghana. Though naturally we would like to see the prices of things go down, people are more thrilled to see the prices of the goods and services they provide rise. For instance in Ghana, producers of poultry products aggressively crusade for higher prices for their products and yet they congregate to complain about inflation. Most people in one way or the other are found with this behavior. It is common to find people complaining about inflation. Traders in Makola and other markets take advantage of inflation to price discriminate and yet they demonstrate against higher prices. Adding to this, home owners who have had the value of their homes risen sharply who tend to benefit from inflation will mostly be seen congregating to demonstrate higher inflations.

The government of Ghana as a solution to address the needs of Ghanaians opted for the IMF bailout. Is the IMF an ideal choice for the government of Ghana? At present, the cedi seems to be appreciating. Will the sellers and producers of Ghana also reduce price to be commensurate to the rate of inflation? Also, is the inflation rate quoted by the Ghana Statistical Service a CPI rate or GDP deflator rate? Is inflation the obstacle to Ghana's economic prosperity? Can a monetary union like the ECO ever solve Ghana's inflation problems? These questions will be dissected and critically evaluated in the next paper.

VI. CONCLUSION & RECOMMENDATION

The purpose of this paper was to elucidate that inflation in Ghana is a monetary phenomenon. This emanates from a more rapid increase in the quantity of money than outputs. Inflation generates overtime and rectifying inflation takes time as observed in the Japanese experience. The key remedy for the government of Ghana is to stop printing money and regulate the supply of money through the use of its monetary policies like the open market operations, cash ratios, bank rates and special deposits to control the supply of money in the system.

Also government should reduce its expenditure. The government of Ghana should only spend money on productive ventures with accountability and eschew expenditures on ambitious projects and ventures. Policies that contribute to high production should be pursued by governments.

In addition to this, the government can use its fiscal policies of taxation by extending the tax bracket to mobilize more revenue instead of printing money. The government furthermore can use taxation to correct demand pull inflation.

Finally, the government should control wages and salaries. The government should expend financial resources sagaciously to pay wages and salaries. Wages and salaries should not be increased arbitrary without any matching by production.

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