



**UNIVERSITY
OF GHANA**

NEXUS BETWEEN MONETARY AND FISCAL POLICIES AS INSTRUMENTS FOR ECONOMIC DEVELOPMENT: WHAT AUDITORS MUST KNOW

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INTRO DUCTION

- **Monetary policy** concerns the use of monetary instruments such as credit, money supply, and interest rates to influence overall demand in the economy.
- Monetary policy thus refers to the actions of central banks, in our case the Bank of Ghana (BoG), to achieve macroeconomic policy objectives such as price stability, full employment, and stable economic growth.
- **Fiscal policy**, on the other hand, is the use of government taxes and expenditure, including debt, to control aggregate demand in the economy.
- Fiscal policy thus refers to the tax and spending policies of a national government, in our case, the Government of Ghana.

INTRO DUCTION

- The main instruments of monetary policy are open market operations, reserve requirements, and the discount rate.
- Other key tools include interest rates on reserves, quantitative easing, and qualitative measures like credit rationing and moral suasion.
- These are used by central banks to manage the money supply and control inflation.



Some
Quantitative
Instruments used
by Central
Banks

➤ **Open market operations:**

- ❖ The central bank buys or sells government securities to manage the money supply.
- ❖ Buying securities injects money, while selling them removes money from circulation.

➤ **Reserve requirements:**

- ❖ This is the percentage of deposits that commercial banks must hold in reserve, rather than lend out.
- ❖ A higher requirement reduces the amount of money available for lending, while a lower one increases it.

➤ **Discount rate:**

- ❖ The interest rate at which commercial banks can borrow money directly from the central bank.
- ❖ A higher rate discourages borrowing, while a lower rate encourages it.



Some
Quantitative
Instruments used
by Central
Banks



➤ **Interest on reserves:**

- ❖ The interest rate a central bank pays on commercial banks' reserves held at the central bank.
- ❖ This can influence banks' willingness to lend money.

➤ **Quantitative easing (QE):**

- ❖ An unconventional tool where a central bank injects liquidity into money markets by purchasing assets.



Some
Qualitative
Instruments used
by Central
Banks



- **Margin requirements:**
 - ❖ The difference between the value of a security and the amount of money a bank is willing to lend against it.
 - ❖ Changing this requirement can encourage or discourage borrowing for investment.
- **Credit rationing:**
 - ❖ The central bank can limit the amount of credit available for specific sectors or types of borrowers.
- **Moral suasion:**
 - ❖ The central bank uses its influence and authority to pressure commercial banks to follow certain policies or guidelines.
- **Direct action:**
 - ❖ Taking specific enforcement actions against banks that fail to comply with monetary policy.

Bank of Ghana's primary monetary policy

- The Bank of Ghana's primary monetary policy objective is to maintain stability in the general level of prices, as stated under section 3 of the Bank of Ghana Act 2002, targeting a medium-term inflation rate of 8 ± 2 percent.
- It implements this through an interest rate-oriented framework using a policy rate called the Monetary Policy Rate (MPR).
- The bank uses instruments like repurchase agreements (repos), open market operations, term deposits, and reserve requirements to align the overnight interbank rate with the MPR.
- Recent policies have focused on tightening to bring down inflation, leading to a reduction in the policy rate from 28% to 25% as inflation has fallen towards the target band.

Key monetary
policy
objectives of
the
Bank of
Ghana

- **Price stability:** Maintain inflation within the medium-term target band of 8 ± 2 percent.
- **Economic growth:** Support the government's economic policy to foster sustainable growth.
- **Financial stability:** Promote and maintain a sound financial sector with efficient payment systems.

Monetary policy tools of the Bank of Ghana

- **Monetary Policy Rate (MPR):** The main policy rate, which the bank uses to influence the cost of money.
- **Repurchase agreements (repos):** A tool to manage liquidity in the banking system.
- **Open market operations (OMO):** The bank uses instruments like its own bills to buy or sell securities on the open market.
- **Term deposits:** Deposits with a fixed term to manage liquidity.
- **Reserve requirements:** The amount of reserves banks must hold against deposits.

Recent policy developments of the Bank of Ghana

- **Rate cuts:** The Monetary Policy Committee recently cut the MPR from 28% to 25% due to improved macroeconomic conditions and falling inflation.
- **Inflation target:** Inflation has fallen to a four-year low of 9.4 percent, meeting the target band, which the bank attributes to its tight monetary policies.
- **Monetary policy framework:** The Bank of Ghana is shifting its decision-making process to a majority vote system, similar to other major inflation-targeting central banks.

Fiscal Policies of the Ministry of Finance

- Ghana's current fiscal policies, guided by the Ministry of Finance, focus on restoring economic stability through structural reforms like establishing an independent Fiscal Council, setting a 45% debt-to-GDP ceiling by 2034, and implementing fiscal discipline.
- Key policy actions include a new tax regime with proposed VAT reforms (abolishing COVID-19 levy, reducing rate), the removal of the e-levy and other taxes, and improved expenditure control, all aimed at achieving a primary surplus and sustainable growth.

▲
**Key fiscal
policy areas
of the
Ministry of
Finance**
▼

- **Fiscal discipline and debt reduction:**
- The government is enforcing strict expenditure and commitment controls.
- The fiscal anchor is the primary surplus, which exceeded the target in the first half of 2025.
- A new fiscal rule has set a debt-to-GDP ceiling of 45% by 2034.

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**Key fiscal
policy areas
of the
Ministry of
Finance**
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- **Tax reforms and revenue generation:**
- The 2025 Budget proposed abolishing the e-levy and withholding tax on lottery winnings, which has been done.
- VAT reforms include abolishing the COVID-19 levy, reducing the effective VAT rate, and increasing the registration threshold to exempt small businesses.
- The tax on unprocessed gold exports has been removed to curb smuggling.
- Compliance will be improved through public education and the introduction of electronic devices.

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**Key fiscal
policy areas
of the
Ministry of
Finance**
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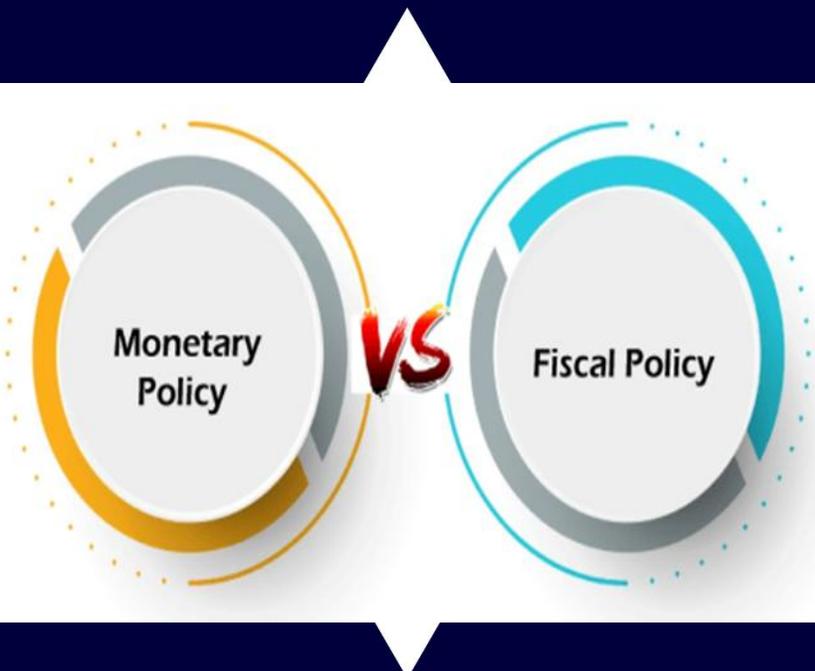
- **Institutional and governance reform:**
- An independent Fiscal Council is being established to provide oversight of fiscal policy.
- The Public Financial Management (PFM) Act has been amended to support these reforms.
- Enforceable sanctions for fiscal mismanagement are being introduced.

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**Key fiscal
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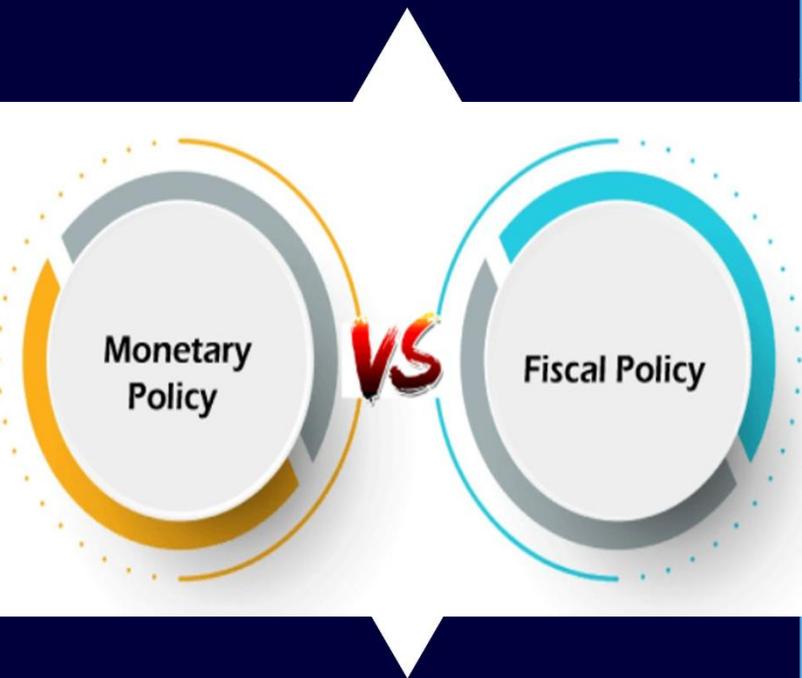
- **Economic growth and stability:**
- Policies are designed to reset the economy for sustainable growth driven by productivity, not just factor accumulation.
- The government aims to stabilize the exchange rate and lower prices.
- Efforts are being made to leverage the demographic dividend by creating jobs for the growing labour force.

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**Key fiscal
policy areas
of the
Ministry of
Finance**
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- **Public financial management:**
- The Ministry is working to restore stability to the economy through structural reforms.
- The mid-year review reported strong performance in tax revenue and a primary surplus.
- A greater emphasis is being placed on transparent and participatory governance, with public input sought for the 2026 budget.



Fiscal Policy	Monetary Policy
Change in government spending and tax rates	Change in interest rates / money supply
Set by the Government (MoF in our case)	Set by a Central Bank (BoG in our case)
No specific target	Target inflation
Side effect on government budget/ borrowing	Side effect on exchange rate and housing market
Strong political dimension to changing tax rates	Mostly independent from the political process



	Fiscal Policy	Monetary Policy
Tool	Tax and government spending	Interest rates
Effect	Budget deficit	Cost of borrowing/mortgages
Distribution	Depends on which taxes you raise	Higher interest rates hit borrowers but benefits savers
Exchange Rate	No effect on exchange rate	Higher interest rates cause appreciation
Supply-side	Higher taxes (e.g., PAYE) may affect incentives to work	Limited impact
Politics	Changing tax and government spending highly political	Monetary policy set by independent central bank (in our case BoG's Monetary Policy Committee (MPC))
Liquidity Trap	Fiscal policy advised in very deep recession	Cuts in interest rates may not work

Basis of Difference	Fiscal Policy	Monetary Policy
Control	Ministry of Finance (MoF)	Central bank of the country (BoG)
Complexity	Less complex	Comparatively more complex
Nature	Changes yearly post annual review (Annual Budget and Mid-year Budget Review)	Changes as and when the economy needs to change
Focus	To ensure development and growth	To maintain economic stability
Work subject	Works on government spending and revenue mobilisation	Works on the flow of money in the economy and the credit control
Political Influence	Political influence exists	No political influence
Tools used	Tax rates, demoneitisation, and rationalisation of government expenditure, to name a few	Cash reserve ratios, interest rates, and reserve requirements, to name a few

NEXUS BETWEEN MONETARY AND FISCAL POLICIES



- **Monetary policy is contractionary**, while **Fiscal policy is expansionary**: The increased government spending or tax cuts will lead to higher aggregate demand.
- Increased government borrowing and tighter money supply will increase interest rates, causing private consumption and output to shrink.

NEXUS BETWEEN MONETARY AND FISCAL POLICIES



- A combination of fiscal and monetary policies can be used to restore an economy to full employment.
- Fiscal and monetary policies are frequently used together to restore an economy to full employment output.

NEXUS BETWEEN MONETARY AND FISCAL POLICIES



- Generally speaking, an increase in taxes tends to dampen economic growth by reducing consumer spending and company profits.
- In turn, this would lead to a fall in the equity market.
- If taxes are lowered, consumers have more money to spend and companies have higher profits, supporting an increase in the equity market.

NEXUS BETWEEN MONETARY AND FISCAL POLICIES



- Theory predicts that inflation can become unstable when policymakers are in conflict about their post-recession recovery strategies, with the fiscal authority actively borrowing and spending to stimulate economic growth while the monetary authority raises interest rates to tame inflation.
- However, they both target aggregate demand to overcome business fluctuations when both are insulated from the political process.
- They are both effective when the economy suffers from real shocks.

ROLE OF MONETARY AND FISCAL POLICIES IN ECONOMIC DEVELOPMENT

- By regulating price changes and other aspects of the economy, monetary policy is essential to the development of impoverished nations.
- This is accomplished by properly adjusting the relationship between the supply and demand for money.
- The demand for money continues to rise as the economy grows.



ROLE OF MONETARY AND FISCAL POLICIES IN ECONOMIC DEVELOPMENT

- This benefits the populace and the economy because more jobs lead to a higher standard of living.
- Reducing tax rates and increasing spending also improve the economy as they serve as incentives for entrepreneurs.
- Fiscal policies also aid in budget deficit reduction.



ROLE OF MONETARY AND FISCAL POLICIES IN ECONOMIC DEVELOPMENT

- Fiscal policy can contribute to lowering inflation both by directly reducing aggregate demand and by making the disinflationary policy package more credible.
- Inflation is typically fought through tightening monetary policy, which raises interest rates and causes a recession that lowers price pressures.



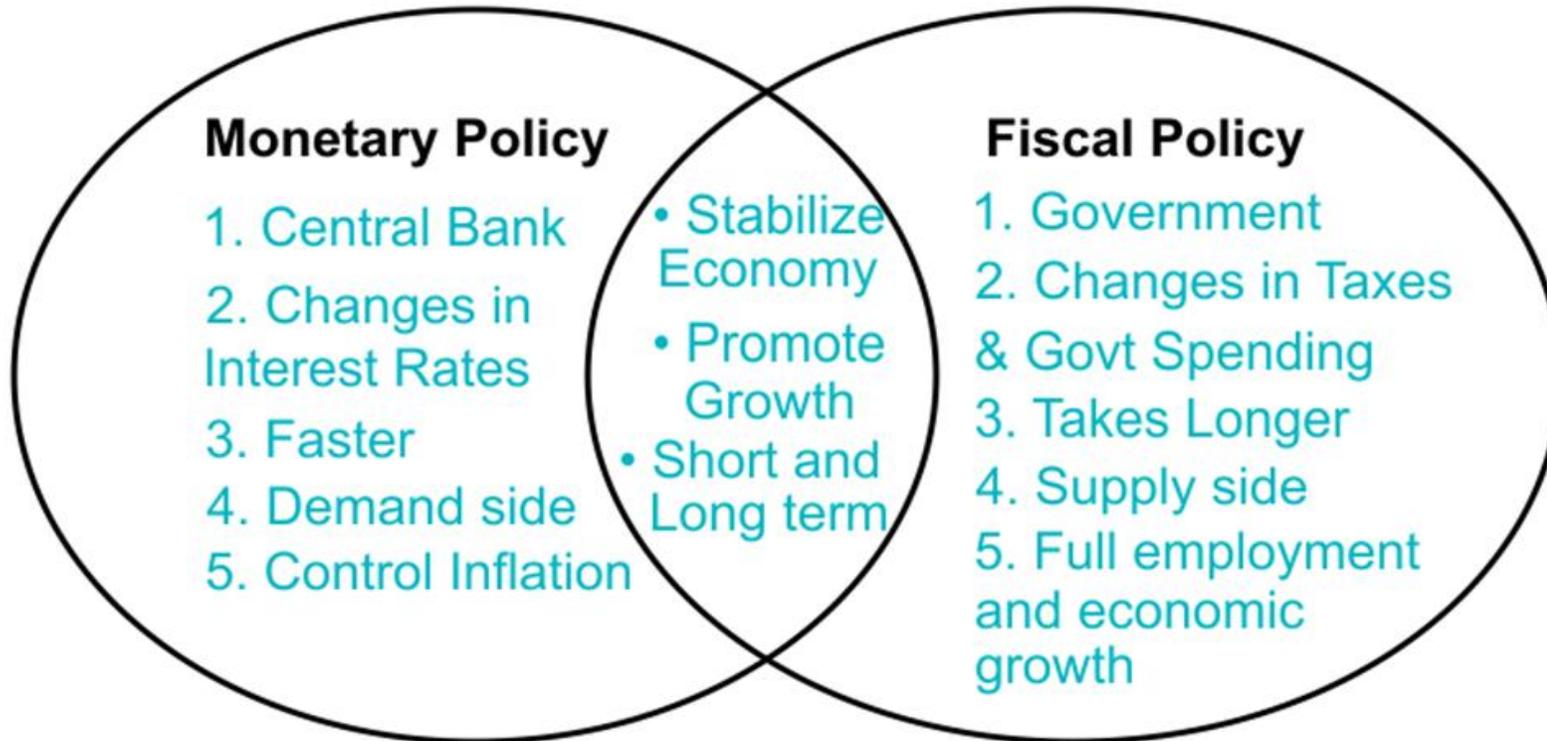
WHEN TO USE MONETARY OR FISCAL POLICIES IN ECONOMIC DEVELOPMENT

- **Monetary policy** addresses interest rates and the supply of money in circulation, and it is generally managed by a central bank (BoG).
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- **Fiscal policy**, on the other hand, addresses taxation and government spending, and it is generally determined by government legislation.
- If an active monetary and fiscal policy is implemented, the central bank's activities are focused on ensuring price stability.
- The fiscal policy's priority is associated with creating favourable conditions for economic growth through the appropriate regulation of revenues, expenditures, and budget deficit.



WHEN TO USE MONETARY OR FISCAL POLICIES IN ECONOMIC DEVELOPMENT

Monetary Policy Vs Fiscal Policy



WHAT AUDITORS MUST KNOW

- ❖ Auditors must understand the nexus between monetary and fiscal policies to assess their combined impact on economic development and ensure effective government and central bank operations, as they are the watchdogs of the economy.
- ❖ This knowledge is crucial for evaluating the government's fiscal position, the central bank's monetary control, and the overall macroeconomic stability, as policy decisions are interconnected and can have synergistic or conflicting effects on growth, inflation, and debt.
- ❖ Auditors must also be aware of how factors like financial market development, central bank independence, and the specific challenges of Ghana's economy influence the effectiveness and coordination of these policies.

WHAT AUDITORS MUST KNOW

How Monetary and Fiscal policies are interconnected

- ❖ **Interdependence:** Monetary policy tools like interest rates affect government borrowing costs, while fiscal policy (government spending and taxation) impacts aggregate demand and economic stability, which in turn influences the effectiveness of monetary policy.
- ❖ **Coordination:** Effective economic development requires coordination, though the optimal level of coordination is debated and can be complex, especially in Ghana, with structural challenges. *Auditors should examine the degree and nature of this coordination.*
- ❖ **Conflicting goals:** Policies can have conflicting goals, such as a government needing to increase spending for development while the Bank of Ghana needs to raise interest rates to control inflation. *Auditors must assess if the goals are being balanced or if one policy is undermining the other.*

WHAT AUDITORS MUST KNOW

Impact on government finances

- ❖ **Fiscal deficits:** The government's fiscal deficit can be financed through money creation (in less developed markets) or through marketable securities, which affects interest rates and central bank operations. *Auditors must check that the financing methods are sustainable.*
- ❖ **Debt management:** *Auditors must evaluate the government's debt management strategy in relation to the monetary policy stance.* For example, a tight monetary policy can increase the cost of servicing government debt.
- ❖ **Crowding-out and inflation:** In countries such as Ghana, with limited financing options, large fiscal deficits can lead to "crowding-out" private investment and cause inflation. *Auditors should assess these risks and whether policies are mitigating them.*

WHAT AUDITORS MUST KNOW

Auditor's role in assessment

- ❖ **Risk assessment:** Auditors must **identify** and **assess** the **risks** associated with the interplay of monetary and fiscal policies, such as the risk of runaway inflation, unsustainable debt, or a crisis resulting from poor coordination or flawed policy choices.
- ❖ **Evaluating policy effectiveness:** Auditors need to **assess** whether the combined policies are achieving the intended outcomes, like sustainable economic growth and macroeconomic stability. This requires understanding the specific context, including the level of financial market development.

WHAT AUDITORS MUST KNOW

Auditor's role in assessment

- ❖ **Central bank (BoG) independence:** Auditors must **understand** the implications of central bank independence. While it can prevent direct political pressure on monetary policy, it may also lead to indirect reactions that are influenced by the quality of fiscal adjustment. *Auditors should review the mechanisms in place to ensure independence is used effectively for the public good.*
- ❖ **Developing country context:** In developing economies, such as ours, auditors must be **particularly aware of the impact** of structural challenges like limited fiscal space, external debt dependency, and vulnerability to global shocks, which complicate policy implementation and can have a disproportionate effect on development outcomes.

CONCLUSION

- An understanding of the nexus between monetary and fiscal policies as instruments for economic development is key to the mandate of the Internal Audit Agency.
- With the tacit understanding, the Internal Audit Agency can set the requisite standards and procedures to govern its activities and functions in all Covered Entities.
- It will also be able to undertake its oversight mandate to coordinate, facilitate, and provide quality assurance for internal audit activities within Ministries, Departments, and Agencies (MDAs) and Metropolitan, Municipal, and District Assemblies (MMDAs)



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THANK YOU

END OF PRESENTATION

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