

MAKRO İKTİSAT ÇALIŞMALARI

Editör: Doç.Dr. Şahin Karabulut

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UNVEILING THE IMPACT OF GOVERNMENT SIZE ON LABOR MARKETS IN ECOWAS¹

Salim SAIDY²

Serife GENC ILERI³

1. INTRODUCTION

Several economic crises, particularly in emerging nations, have exerted detrimental consequences on various facets of those nations' growth. Considering these crises, policymakers and researchers have been more interested in this discourse, pushing for government intervention to control economic conditions. This is because even though the long-term economic development is endogenous, government policy impacts it positively or negatively. By stabilizing and influencing economic circumstances, the government may make sure that economic growth is sustainable and beneficial to society. Policy makers in many countries often utilize fiscal policy as a means to address

¹ This chapter is derived from Salim Saidy's MA in Economics thesis defended in 2023 which can be accessed from <https://openaccess.ihu.edu.tr/entities/publication/3f660654-aea9-4714-af06-a4050ed0ae76>

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market failures and mitigate their adverse effects. In a broader sense, fiscal policy is implemented to manage expenditure levels, regulate taxation, and make effective resource allocations. In essence, fiscal policy operates as a way through which a state governs the economy (Anayochukwu, 2012). As Falade and Folorunso (2015) underlined, budgetary policy can be utilized to stimulate the economy via influencing expenditure and taxes. Diminishing unemployment rates and fostering economic growth are the key objectives of fiscal policy.

In this chapter, we explore the relationship between government size and unemployment in the Economic Community of West African States (ECOWAS) between 1991 - 2021.⁴ In addition, we also aim to observe how the relation of government size and unemployment varies within the region by comparing the two existing economic and monetary unions: WAEMU and WAMZ. Our findings indicate the presence of a significant and positive relationship between government size and unemployment rate within the ECOWAS region. This outcome remains consistent across all three estimation methods used. Hence, a percentage rise in government size in the ECOWAS region will likely result in a corresponding rise in unemployment rate. This finding is aligned with the Abrams (1999) curve and is also consistent with the results of Okunola (2021), which explored the link between ECOWAS' employment dynamics and its fiscal policy. However, the relationship between government investment spending and unemployment is negative, meaning a

⁴ Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo are currently the fifteen (15) West African nations that comprise the Economic Community of West African States (ECOWAS).

bigger government investment expenditure has a prospect to reduce unemployment. While population growth shows strong positive relationships, FDI, Inflation and GDP per capita growth illustrate weak relationships. When WAEMU and WAMZ regions are compared, interesting findings emerge. While the relationship between government size and unemployment rate shows negative coefficient across the WAEMU region, it appears to be positive in WAMZ regions.

2. DATA AND METHODOLOGY

To explore the connection in relation to government size and rate of unemployment, we use data available in the World Bank's WDI database. Overall, the analysis encompasses twelve of the available fifteen ECOWAS countries. Countries like Liberia, Guinea, and Cabo Verde were excluded due to inadequate data availability. To ensure consistency and address any potential issues with missing data, the study carefully selected panel data from the aforementioned countries, covering 1991 and 2021. Rate of unemployment (UNEMP), measured as a proportion of overall labor force, is dependent variable in this research. Primary independent variables examined involved general government consumption expenditure (GOV_SIZE) and gross fixed capital formation (GOV_INV), both expressed as percentages of GDP. In addition, several control variables are included in the analysis. These consist of inflation (INF), yearly proportion change in CPI; GDP per capita (Y) growth rate; and population (POP) growth rate. These control variables are incorporated to consider their potential impact on the unemployment rate. By employing this comprehensive dataset and considering various relevant variables, the research seeks to review the interaction regarding government size and unemployment of ECOWAS. It also aims to analyze potential

variations or discrepancies in relation to the size of government and unemployment within two sub- unions of ECOWAS: WAEMU and WAMZ.

We explore the relationship linking unemployment and the size of government of ECOWAS countries. As we delve into this study, we seek to discover if effect of size of government on the rate of unemployment varies in the West African region by comparing the West African Economic and Monetary Union (WAEMU) and the West African Monetary Zone (WAMZ). The size of the government's connection with respect to unemployment appeared to be a complicated one that defies a single theoretical explanation. However, we adhere to the Keynesian theory which suggests that unemployment is primarily caused by insufficient aggregate demand in the economy. Therefore, government intervention through expansionary measures is necessary to stimulate economic activity and address unemployment issues.

Hence, the panel data regression takes the following form:

$$UNEMP_{it} = \alpha + \beta_1 GOV_SIZE_{it} + \beta_2 GOV_INV_{it} + \beta_3 FDI_{it} + \beta_4 INF_{it} + \beta_5 Y_{it} + \beta_6 POP_{it} + \mu_{it}$$

We use the DOLS model introduced by Stock and Watson (1993). This technique utilizes a parametric approach to estimate long-term connection in a given regression with integrated variables in different orders but cointegration exists among the variables.

3. RESULTS AND DISCUSSIONS

3.1. Summary Statistics

Prior to initiating the analysis, it is crucial to perform descriptive statistics to summarize the research data. The key

variables' summary statistics and their discussions are illustrated below.

Table 1. Summary Statistics- ECOWAS

Variable	Obs.	Mean	Std. Dev.	Min	Max
UNEMP	372	4.870	2.605	0.32	11.71
GOV_SIZE	372	11.985	4.337	.911	26.065
GOV_INV	372	18.642	7.523	-2.424	48.4
FDI	372	2.43	3.093	-2.545	32.301
INF	372	7.97	13.039	-7.797	102.697
Y	372	1.141	4.305	-29.413	19.457
POP	372	2.733	0.672	-1.765	5.785

The data reveals important patterns and characteristics among the variables. Government Investment Expenditure is observed to have a higher average value (18.642) compared to Government Size (11.985) across ECOWAS member states. The prioritization of investment expenses implies a strategic concentration on sustained economic development, recognizing the importance of allocating resources to crucial domains like education and infrastructure.

Among the variables, the indicators displaying the lowest average figures are FDI and GDP per capita. This implies that, the countries in the sample have relatively lower levels of income per person and foreign investment inflows on average. On the other hand, inflation demonstrates a moderate mean value, but it stands out with the highest standard deviation, almost twice as large as the next variable. This wide variation in inflation rates among ECOWAS countries signifies substantial heterogeneity, with some nations experiencing significantly higher or lower inflation than the average. Such divergence in inflation rates can have significant implications for economic stability and performance. Rapidly rising inflation rates erode consumers' purchasing power and introduce uncertainties for businesses, while persistently low inflation may signal sluggish demand and

below-par economic growth. Consequently, it becomes imperative to analyze the underlying factors contributing to these divergences in inflation rates. Such analysis can assist policymakers in formulating appropriate monetary and fiscal policies aimed at fostering price stability and enhancing overall economic prosperity.

Table 2. Summary Statistics-WAEMU

Variable	Obs	Mean	Std. Dev.	Min	Max
UNEMP	248	4.26	2.466	.32	11.71
GOV SIZE	248	13.647	3.815	6.408	26.065
GOV INV	248	18.611	5.841	5.885	48.397
FDI	248	1.79	2.245	-2.545	18.818
INF	248	4.381	9.831	-7.797	69.584
Y	248	1.088	3.88	-29.413	14.583
POP	248	2.825	.556	-.68	4.467

Table 3. Summary Statistics- WAMZ

Variable	Obs	Mean	Std. Dev.	Min	Max
UNEMP	124	6.088	2.452	3.388	11.212
GOV SIZE	124	8.662	3.287	.911	15.308
GOV INV	124	18.702	10.108	-2.424	48.4
FDI	124	3.709	4.033	-.971	32.301
INF	124	15.15	15.517	-.918	102.697
Y	124	1.247	5.065	-22.488	19.457
POP	124	2.547	.83	-1.765	5.785

Tables 2 and 3 reveals notable distinctions regarding the West Africa Economic and Monetary Union (WAEMU) in connection to the West African Monetary Zone (WAMZ). The notables are government size, inflation rate, and unemployment rate. Firstly, WAEMU exhibits a larger government size, as indicated by a mean value of 13.647, compared to WAMZ with a mean value of 8.662. Despite this disparity, both blocs display similar levels of variation in government size, as reflected by their comparable standard deviation figures. Moreover, a prominent contrast arises in the inflation rates between the two unions. On average, the inflation rate of WAMZ is three times more

compared to WAEMU. Especially, the inflation rate in the WAMZ exhibits considerable volatility, evidenced by a substantial standard deviation value of 15.15, surpassing its average rate. In contrast, the WAEMU region displays a lower mean inflation rate, yet still possesses a relatively higher standard deviation, implying significant fluctuations in inflation across both blocs. While the rate of unemployment in WAEMU is approximately half that of WAMZ, both regions exhibit comparable levels of variation in unemployment rates. This indicates a comparable level of ambiguity and heterogeneity in employment trends within both economic unions.

3.2. Panel Empirical Results

Table 4. Panel Regression Results

VARIABLES	(1) ECOWAS	(2) WAEMU	(3) WAMZ
GOV_SIZE	0.8674*** (0.1277)	-0.5579*** (0.0672)	0.4177*** (0.0620)
GOV_INV	-0.4336*** (0.0584)	0.2338*** (0.0319)	0.1550*** (0.0156)
FDI	-0.0093 (0.0401)	-0.2502*** (0.0144)	-0.1532*** (0.0191)
INF	-0.1511*** (0.0453)	0.0442*** (0.0141)	0.1103*** (0.0116)
Y	-0.0448 (0.0545)	-0.5196*** (0.0247)	0.0473* (0.0254)
POP	0.3049 (0.3588)	-3.4503*** (0.1835)	0.7104*** (0.1213)

Notes: (***), (**) and (*) represent statistical significance at 1%, 5% and 10% levels respectively. standard errors are in parentheses.

The results for the ECOWAS region support the Abrams curve, originally introduced by Abrams (1999), which establishes positive nexus connecting government size and unemployment. Similar conclusions have been drawn in other studies, including

those conducted by Aysu et al. (2011), Christopoulos & Tsionas (2002), and Feldmann (2006).

Upon analyzing the outcomes for WAEMU and WAMZ, distinct patterns emerge, showcasing mixed results between the two sub-blocs. Regarding the sort of linkage between size of government and rate of unemployment, there exist contrasting findings. Within the WAEMU sub-bloc, DOLS estimation shows unemployment could potentially be reduced by 0.558% with just a 1% increment in government size. Conversely, for the WAMZ sub-bloc, the scenario takes a completely different turn, as all methods unveil a correlation of government size and unemployment is positive at significance level 1%. In addition, the DOLS estimation suggest that if government size expand by 1%, that of unemployment will also go up for about 0.418%.

These diverging results on the influence of government size on unemployment can be attributed to the distinct economic conditions prevailing within each sub-bloc. These varying circumstances could contribute to the different outcomes observed between the two regions. Although both WAEMU and WAMZ share the objective of aligning macroeconomic policies across their member states, they diverge in terms of their government size and associated policies.

WAEMU has a regional surveillance mechanism that monitors and evaluates the compliance of member states with the fiscal regulation and other macroeconomic instruments that are in line with the implementation of the common policies and programs of the union. Therefore, fiscal policy decisions such as expenditures are coordinated and monitored in such a way that allow discipline spending and putting resources into sectors that are development oriented. Hence, creating a platform for effective and responsible spending policies in the region as member states are bound by the regulation that oversee the

convergence criteria in the WAEMU states. According to Manasse et al. (2005) and Buti et al. (2001), this measure is essential to the economic synchronization of nations, and adherence with it enables economic integration and ensures growing level of fiscal discipline. The existence of common currency and policy restrictions within this bloc makes it more resistible to market inefficiencies and also encourages responsible and discipline spending. As a result, Kebalo and Zouri (2022) reached the conclusion that implementing the fiscal convergence criterion in the bloc enhances the improvement of business cycles harmonization through the coordination of economic policies. In contrast, there exists no such mechanism in WAMZ countries. This is because the bloc has a more decentralized structure that heavily depends on national authorities and working groups to report their data on key fiscal variables such as expenditure.

Although a goal of achieving a unified fiscal outlook exists, the member states are not under any urgency to harmonize their expenses. Additionally, WAMZ has more room for adjustment and independence of fiscal policy as they enjoy fiscal sovereignty and policy flexibility. But this self control and autonomy has a cost as it exposes countries within WAMZ to more economic and market shortcomings. For example, the exchange rate regime in WAMZ countries is flexible, and the rate of the respective nation's currencies are decided by the influences of demand and supply. Since these countries are import dependent, the demand for foreign currencies is usually high, which often leads to inflationary pressures and hence increases the cost of imported goods and services. This eventually raises the amount of money the government spends on consumption, which is found to have a positive relationship with unemployment. For WAEMU, on the other hand, a fixed exchange rate regime exists. This is because they have a single

currency, the CFA franc, which is fixed to the Euro. Thus, they are less sensitive to market shortcomings.

Moreover, within the WAEMU region, there exists a fiscal regulation as a component of its convergence criteria, which restricts the overall fiscal deficit to 3% of GDP. In contrast, the WAMZ countries adopt a more lenient approach by setting the overall fiscal deficit limit at 4% of GDP. Despite the challenges faced by both countries in meeting and maintaining the regulatory threshold, it appears that the countries within WAEMU derived greater advantages from the aforementioned regulation. Generally, many believe that WAMZ members, due to their economic freedom and autonomy, should experience a more promising economic outlook characterized by progress and development. This is because the individual countries have their own central banks and their governments are often free from interference, so they are expected to govern their economic affairs effectively. Contrary to expectations, the findings of this study have revealed a contrasting reality, evident in the disparity of government size between the WAMZ and WAEMU regions. In the context of the WAMZ, a larger government size appears to have an undesirable bearing on unemployment, whereas in the case of WAEMU, it demonstrates a positive impact.

One potential rationale for the favorable influence of government size on unemployment rates in countries within the West African Economic and Monetary Union (WAEMU) is linked to its association with its previous colonial power, France. WAEMU countries share a single currency pegged to the Euro, with the central bank of the region maintaining an account with the Treasury of France. Under this particular monetary framework, the West African Central Bank is mandated to deposit half of its foreign currency reserves into the coffers of the French Treasury, obligating itself to directing no less than 20% of its foreign currency balances towards sight liabilities, and the bank

is also constrained in its ability to access no more than 20% of the previous year's revenue (Ibrahim, 2020). The purpose of this action is to ensure the continued sustainability of the West African CFA franc in the global market through the prevention of occurrences such as inflation hikes, currency devaluation, and fiscal turmoil. Although there have been accusations of neo-colonialism against Paris, the conditions associated with the CFA franc zone have generally proved to be effective in promoting increased stability and growth within the economies of WAEMU, when compared to those of WAMZ. This is because due to limited financial resources at their disposal and the existence of oversight measures, WAEMU countries are forced to determine the sectors into which they inject their financial funds. For the West African Monetary Zone (WAMZ), the situation presents a marked contrast. Devoid of any colonial-related pressures, the individual countries are free to administer their internal affairs, including monetary and fiscal policies. This, however, can lead to an increase in imprudent spending and unsound policy decisions.

WAEMU and WAMZ countries can also be distinguished based on their employment culture. As per Faujas Alain (2012), the deputy chairman of the French Council of Investors, Bouthelier Anthony, claims that nations with an Anglo-Saxon culture tend to prioritize business and entrepreneurship, and individuals in such nations are less willing to aspire for public service positions compared to those with a French cultural background. Thus, it can be inferred that citizens of WAMZ are mainly preoccupied with generating job prospects for themselves, therefore placing less reliance on the government to secure employment. In such countries, the authorities are not forced to allocate financial resources towards areas that primarily generate employment, thereby leading to the channeling of funds into sectors that do not directly influence employment prospects. Hence, an increase in government size will likely lead to a

corresponding rise in unemployment rates, which has a detrimental impact on the economy. Conversely, countries that belong to the WAEMU bloc are more prepared to be absorbed by the public sector for employment. The appetite towards job seeking rather than entrepreneurialism is evident among them. This social tendency compels the government to devise and allocate their expenditures towards initiatives that can yield sustainable employment prospects for their populace. As a result, an upsurge in the size of government could potentially decrease unemployment rate, as the government continues to devote more funds into sectors that are inclined towards generating employment opportunities.

4. CONCLUSION

This chapter analyzed the nexus between the size of government and unemployment rate in ECOWAS from 1991 to 2021. Apart from examining the overall relationship between these variables across ECOWAS, we studied potential variations or discrepancies in this relation within WAEMU and WAMZ.

Our results revealed a consistent and substantial positive connection concerning government size and unemployment within the ECOWAS region. Based on the discoveries, a percentage surge in government size is linked by a corresponding rise in the rate of unemployment within the region. Specifically, the rate of unemployment is projected to rise by 0.867% in the ECOWAS region for the DOLS, this evidence shows expansionary fiscal policies, often advocated by Keynesian economics, are not effective in addressing high unemployment rates of ECOWAS. Actually, the findings suggest that as government size expands, the unemployment rate tends to rise, holding all other factors constant. These findings align with the Abrams (1999) curve and is also consistent with the results of

Okunola (2021), who explored the link regarding employment dynamics and government policy in ECOWAS and found that when government expenditure goes up employment levels falls. However, when WAEMU and WAMZ regions are compared, interesting findings emerged. While the relationship is estimated to be negative in the WAEMU regions, its coefficients are positive in WAMZ regions. This huge variation in the connection pertaining to government size and unemployment rate is owed to the distinct nature of the economic conditions prevailing within the two sub-blocs.

It is evident that several key variables affect the rate of unemployment in the ECOWAS region. Accordingly, policymakers should prioritize redirecting unnecessary government consumption spending towards labor-reliant public investments and underline the attraction of foreign direct investment while implementing measures to control inflation. It is evident that undisciplined government expenditure, particularly in non-labor-driven areas, will exacerbate the unemployment rate in the region. Therefore, governments within the ECOWAS region should strongly consider reducing the size of their government as a crucial mechanism for addressing the unemployment challenge. Additionally, it is imperative for the governments to actively pursue strategies aimed at promoting investment in vital areas of the economy, like infrastructure and education, as they play an important function in mitigating escalating rate of unemployment in the long run. Strategic investments in sectors that bolster economic growth and create employment opportunities will undoubtedly pose an influence on addressing challenges of unemployment in ECOWAS.

Furthermore, it becomes essential for government to adopt measures aimed at reducing general government consumption expenditure, as excessive spending in inappropriate sectors can impose significant restrictions on economic growth and impede

employment opportunities. By implementing a comprehensive approach that includes efforts to strengthen economic growth, aiming government and foreign direct investments, and responsible consumption expenditure, governments in the region can pave the way for a more viable labor force, ultimately contributing to the lessening of unemployment in the region.

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