

**THE FISCAL AND MONETARY CONDUCTS IN
NIGERIA: AN INTERACTION WITH THE
BALANCE OF PAYMENTS**

RAJI JIMOH OLAJIDE

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**THE FISCAL AND MONETARY CONDUCTS IN NIGERIA:
AN INTERACTION WITH THE BALANCE OF PAYMENTS**

By

RAJI JIMOH OLAJIDE

**Thesis Submitted to
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ABSTRACT

This study examines the fiscal and monetary conducts in Nigeria and their interaction with the balance of payments for the period 1970-2010. It examines how the government adjusts its desired level of nominal expenditure and income from taxes to variations in price level and how fast such adjustments are. Also, the means by which the Nigerian economy absorbs the exchange market pressure (EMP) are determined. Descriptive analysis, three-stage least squares (3SLS), vector error correction model (VECM), autoregressive distributed lag (ARDL) and dynamic ordinary least squares (DOLS) are employed. Evidence from the descriptive analysis suggests that deficit financing mostly through the central bank credit becomes the standard fiscal policy with the implication of increased money supply, rising inflation and balance of payment deterioration. Results from 3SLS show that nominal government expenditure and revenue adjust positively to inflation rate and income level, and government expenditure quickly adjusts while its revenue lags behind. Evidence from VECM reveals that in the long-run and short-run fiscal deficit, price, and private sector credit have significant impacts on money supply. Granger causality results indicate that in the short-run, unidirectional causality runs from money supply to inflation; and from government deficit to price while in the long-run, bidirectional causality runs between money supply and price. Also the DOLS results reveal that domestic credit has a significant negative impact on EMP and that external imbalances are absorbed more by depleting foreign reserves than exchange rate depreciation. These results are capable of providing useful information to policy makers to make useful policies, and to monetary authorities to abide by prudent fiscal operations without relying on the banking system for deficit financing. Generally, the probable policy recommendation is the designation of the appropriate way of achieving credible fiscal behaviour, and the application of credit restriction rules to curtail credit from the banking system for deficit financing.

Keywords: Fiscal Policy, Monetary Policy, Balance of Payment, Exchange Market Pressure, and Autoregressive Distributed Lag Model.

ABSTRAK

Kajian ini meneliti aliran fiskal dan monetari di Nigeria serta interaksinya dengan imbalan pembayaran bagi tempoh 1970-2010. Kajian ini cuba meninjau cara kerajaan menyesuaikan tahap perbelanjaan nominal seperti yang dikehendaki dan pendapatan daripada cukai kepada variasi dalam paras harga, serta kepantasan pelarasannya. Selain itu, cara ekonomi Nigeria menyerap tekanan pasaran pertukaran (EMP) juga dapat ditentukan. Analisis deskriptif yang terdiri daripada tiga peringkat iaitu kuasa dua terkecil (3SLS), model vektor pembetulan kesilapan (VECM), lag edaran autoregresif (ARDL) dan kuasa dua terkecil dinamik formal (DOLS) dilaksanakan. Bukti daripada analisis deskriptif menunjukkan bahawa pembiayaan defisit yang kebanyakannya melalui kredit bank pusat menjadi dasar fiskal standard dengan implikasi peningkatan bekalan wang, inflasi yang semakin meningkat dan kemerosotan imbalan pembayaran. Hasil daripada 3SLS menunjukkan bahawa perbelanjaan kerajaan dan penyesuaian pendapatan nominal adalah positif kepada kadar inflasi dan tahap pendapatan, dan dapat menyesuaikan perbelanjaan kerajaan dengan cepat manakala pendapatannya jauh ketinggalan. Bukti daripada VECM mendedahkan bahawa dalam jangka masa panjang dan defisit fiskal jangka pendek, harga, dan kredit sektor swasta mempunyai kesan ketara ke atas bekalan kewangan. Keputusan kajian penyebab *Granger* menunjukkan bahawa dalam jangka pendek, sebab dan akibat aliran satu arah berlangsung dari bekalan wang inflasi; dan daripada defisit kerajaan kepada harga semasa, dalam jangka masa panjang pula sebab dan akibat dwiarah mengalir antara bekalan wang dan harga. Keputusan DOLS pula mendedahkan bahawa kredit domestik mempunyai kesan negatif yang ketara kepada EMP dan ketidakseimbangan luaran diserap lebih dengan pengurangan rizab asing berbanding susut nilai kadar pertukaran. Keputusan ini mampu menyediakan maklumat yang berguna kepada pembuat dasar untuk membuat dasar-dasar yang berguna, dan pihak berkuasa monetari untuk mematuhi operasi fiskal berhemat tanpa bergantung kepada sistem perbankan untuk pembiayaan defisit. Secara amnya, cadangan dasar yang mungkin boleh dilaksanakan adalah penetapan cara yang sesuai untuk mencapai tingkah laku fiskal yang berwibawa, dan pelaksanaan peraturan sekatan kredit bagi menyekat kredit daripada sistem perbankan untuk pembiayaan defisit.

Kata kunci: Dasar Fiskal, Dasar Monetari, Imbalan Pembayaran, Tekanan Pasaran Pertukaran, dan Model Lag Edaran Autoregresi.

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CHAPTER ONE

INTRODUCTION

1.0 Background of the Study

For sometimes now fiscal themes have become sustainable interest in policy debates in many developed and developing countries. Fiscal policy changes are observed to be the significant cause of the current account deficits and play a prominent role in the determination of the future development of external imbalances (IMF, 2004, 2005). Issues relating to fiscal dimensions such as excessive budget and current account deficits, public debt burdens and weak revenues and the issues of appropriate nature, scope and conduct of fiscal policy to maintain macroeconomic stability and economic growth have become the major focus in policy debates.

The fundamental goal of macroeconomic policy (Monetary and fiscal policy) is not just to ensure full employment level, moderate general price level, welfare improvement, level of economic growth and development but also to guarantee their stability in order to bring about confidence in the economy. Stability of economy enables the government and individual agents to have a well and effective projection for future. In addition, economy stability enhances socio-economic welfare by stabilizing the fluctuations in income and consumption (Swanepoel, 2004).

Monetary policy performs the main function of macroeconomic policy. For this reason it is faced with the challenge of maintaining stable inflation rate in a volatile environment of the economy. In the course of performing this function, the economic goals of the government must also be supported to realize the general macroeconomic objectives. On

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