FISCAL THEORY AND POLICY

SELECTED ESSAYS

Akpan H. Ekpo

Chapter One

MACROECONOMIC POLICY FRAMEWORK: ISSUES AND CHALLENGES FOR NIGERIA

1. INTRODUCTION

The Nigerian economy remains underdeveloped and backward. What is disturbing about the Nigerian economy is the abundance of human and natural resources; nature has been so **unkind** to Nigeria. There are very few countries in the world that are so endowed as Nigeria. In the 1960s and early 1970s, Nigeria, Malaysia, Indonesia, Taiwan, Singapore and South Kcrea had similar income per capita, GDP growth rates and under-developed political structures. Today, the Asian Tigers have escaped under-development and poverty partly because of the way in which their economies were managed.

The Nigerian economy has experienced all the phases of a typical business cycle (decline, depression or recession, recovery, and boom). However, none of the booms (agriculture, oil and financial) resulted in any significant restructuring and transformation of the economy. None of the booms was ever linked to the real sector. Each boom came and disappeared. Nigeria was unable to maximize the benefits associated with economic booms.

Macroeconomic policy suggests upfront that an economy, particularly a capitalist one, must be managed to ensure stability and growth. If left unmanaged, a capitalist economy is subject to business fluctuations that may even threaten the survival of the system. A good example is economic recessions/depressions which are common features in capitalist style economies. It was, therefore, the great depression of the 1930s that fundamentally altered economists perception on the need to managed an economy.

Economists generally agree that an economy must be managed. However, they differ on the nature of the prescriptions depending on the school of thought and the severity of the problem. For example, assuming a severe depression strict Keynesians will proffer fiscal policy as the solution.

The significance of macroeconomic management is the re-echoing of the importance of government as an important economic agent in the economy. In other words, qualitative government intervention particularly as regards policy conceptualization and formulation is crucial for a robust management of the economy. It is such robust management that will minimize the pains of depression or recession.

Nigerian leaders and policy-makers have and will continue to manage the economy through the use of monetary, fiscal, trade (commercial), incomes, exchange rate and debt management policies. An appropriate and robust mix of these policies will determine how best the economy has performed. We intend to examine stylized facts of the Nigerian economy in order to ascertain the effectiveness of these policies.

The objective of this paper is to examine macroeconomic policy framework within the Nigerian context. In the discourse, the challenges tormenting macroeconomic policy environment in Nigeria will be analysed. Our analysis suggests that macroeconomic policy framework in Nigeria must consider the essential features of the economy. Because the Nigerian economy is underdeveloped and poverty is increasing, any macroeconomic policy framework ought to proceed from the known structural rigidities and the disequilibria tendencies within the economy.

2. THEORETICAL UNDERPINNINGS

Macroeconomic theory involves the construction of models of the behaviour of certain economic variables of interest. It is concerned with the behaviour of the most aggregative variables such as a country's output, the general price level and the overall unemployment rate and the balance of payments. It is not too correct to separate economic theory neatly into two boxes labeled "macroeconomics" and "microeconomics". Consistency dictates that the microeconomic propositions about individual and firm behaviour be reflected in the behaviour of macroeconomic aggregates. Macroeconomic analysis are derived generally from micro foundations. However, the questions we seek to answer at the empirical level has made the distinction between macroeconomics and microeconomics reasonable.

Macroeconomics includes the study of the determinants of other broad economic aggregates such as consumption, saving, investments exports, imports and government expenditures. The objective of macroeconomic policy centers on the achievemer.. of output stabilization in the short-run and a diversified self-sustaining economic growth in the long run.

Short-run macroeconomic stabilization implies the prevention of excessive expansion or contraction of income. The stress is to prevent noticeable cyclical movements or fluctuations in the level of income, and by implication, in the levels of employment, prices and balance of payments.

In the long-run, macroeconomic policy are directed at the following national goals:

- full employment, that is, full utilization of all non-labour resources and reduction of excess capacity to a minimum.

- rapid economic growth to guarantee a rising standard of living and increased per capita income for the citizens
- price stability (moderation of the rate of inflation); and
- balance of payments equilibrium, that is elimination of chronic current account and a balance of payments deficits.

For a developing country like Nigeria, other important economic goals include:

- debt management, that is the management of external and internal debts to avoid serious debt-service problems;
- equitable distribution of income;
- elimination of economic dualism, that is, the promotion of rural development;
- provision of basic needs, that is ability to meet the basic needs of the generality of the citizens through the provision of food, clothing, shelter etc, and
- environmental protection.

The implication of the above goals centers on the elimination or reduction of absolute poverty by the conceptualization, formulation and implementation of programmes and strategies. In order to achieve the above goals, policy-makers utilize certain instruments of macroeconomic policy.

2.1 INSTRUMENTS OF MACROECONOMIC POLICY

The two main instruments of macroeconomic policy are fiscal and monetary policy. The other instruments are: (i) commercial or trade policy; (ii) incomes policy; (iii) exchange rate policy; (iv) debt management policy, Fiscal policy and monetary policy are often supplemented with the

other four instruments as and when necessary.

Monetary policy which includes credit and financial policy centers on the use of changes in money supply and/or interest rates to influence the level of economic activity. Monetary policy is anchored on the use of some or all of the following policies.

* open market operations;
* rediscount policy
* minimum reserve requirements;
* liquidity rates
* sectoral credit guidelines

In most developing countries like Nigeria the use of the above policies may be sub-optimum because of the undeveloped money and capital markets.

Fiscal policy involves the use of taxes and changes in government expenditure to influence the level of economic activity. The undeveloped nature of money and capital markets in Nigeria allows emphasis to be placed on the use of changes in government spending. Budget deficits tend to be financed by domestic borrowing; in some developing economies, budget deficits are financed by printing money. Monetisation often results in inflation and provides the dominance of fiscal policy over monetary policy. For a detailed analysis of the other instruments see (Obadan and Iyoha, 1996, pp. 1-16).

It is important to state that the analysis of macroeconomic policy is based on the assumption that all markets do clear and economic agents optimize and consider all available information (rational expectations) in doing so, among others. Within theory, the New-Keynesians within the New Macroeconomics School of Thoughts, in attempting to justify policy intervention, have argued that the labour market may not clear giving the nature of contracts, information in the market etc. In other words, the new macroeconomics school (new-classical and new-Keynesian) assume the competitive nature of the market and attempt to justify whether government intervention (fiscal and monetary policy) can be effective both in the short and long-terms.

Those economists who subscribe to the Kaleckian macroeconomic School of thought examine an economic system from the point of view that markets are not competitive. They assume an oligopolistic market structure and proceed to analyse the impact of monetary and fiscal policy on the level of economic activity.

Giving the underdeveloped nature of the Nigerian economy, orthodox fiscal and monetary policies cannot be as effective as they are in developed industrialized countries. Because markets are not for the most part competitive, it may be reasonable to examine a mixture of policy instruments from the point of disequilibrium. The Nigerian economy is characterized by the following:

- structural bottlenecks and rigidities
- underdeveloped money and capital markets
- oligopolistic market structure
- economic dualism and fragmentation
- inadequate tax system
- high level of corruption
- external dependence of the economy
- primitive accumulative instinct
- a large informal sector.

Building a macro model with the above observations will provide different results since the adjustment process will be different from that of the conventional (orthodox) general equilibrium system. First, disequilibrium models imply that in the short-run, the variable to be adjusted is not price but quantity. Second, because of false trading,

planned income may be different from realized income. Third, in arriving at the new equilibrium set of prices individuals will take information costs into account. Information is no longer free because the opportunity to be able to trade must be foregone while gathering information. Our policy-makers need to start giving thought to macroeconomic modeling of the Nigerian economy from the point of view of disequilibrium.

3. STYLIZED FACTS ON THE NIGERIAN ECONOMY

Based on the fact that the instruments discussed above have been utilized in influencing the level of economic activity in the Nigerian economy, we now examine some evidence.

3.1 The Real Sector

The growth of the agricultural sector which remained at 5.8% between 1990 – 1993 reduced to 3.5% between 1997 – 1998 and further declined to 1.8% during the period 1999 – 2001. During the period 1999 – 2001, agricultural GDP showed an average growth rate of 2.6%. The growth of this sector is disturbing given the fact that agricultural sector employs about 70% of the labour force with an expansive and rich arable land. The agricultural sector should grow between 7% and 10% in order to have any meaningful impact on poverty reduction.

It is important to re-examine the incentives package to farmers so as to increase productivity. The issues of subsidy regarding affordability of fertilizers, credible price-support system and modern production technologies must be revisited if this sub-sector is to contribute to sustained growth and development.

From Table 1, the period 1999 – 2001 witnessed slow growth in all aspects of agricultural production; growth in real output depends on the performance of the agricultural sector.

The performance of the industrial sector was unsatisfactory. Available data (see Table 2) show that between 1990 – 1992 growth in the sector stood at 2.1%. Between 1993 – 1995 growth was –1.3%. However, between 1999 – 2001 growth rose to 6.1%. The slow growth in industrial production can be ascertained from sluggish growth in the key sub-sectors. For the period 1993 – 1995, the growth of manufacturing stood at –8.4%, mining at 3.2% and electricity at 3.1%. The mining sub-sector grew by 7.4% during the period 1999-2001; this may be due to increased activity in the solid mineral sub-sector.

The disappointing performance of manufacturing should be taken seriously especially as manufacturing is supposed to be an "engine of growth". Manufacturing capacity utilization which averaged 75% in the mid-1980s declined sharply to below 50% from 1983 and by 1995 it remained at about 29%. In 1999, capacity utilization was about 30% and rose to about 40% in 2001; this marginal improvement cannot contribute to increased real output in the economy.

There is no question that expansion of manufacturing has been constrained by series of factors such as (i) low effective demand for local manufactured goods; (ii) high cost of domestic production due to high cost of investible funds, increase in tariffs on basic utilities; and (iii) poor infrastructure.

It is important that small-and-medium scale businesses be encouraged; most small and medium-scale businesses are unable to access the facility created by the CBN due to strict conditions by the banks. Since

government has intervened in the provision of credit, it should complete the process by ensuring that the funds are actually disbursed.

Table 1: Nigeria: Growth in Agricultural Production, 1990 – 2001 (%)

	1990-1993	1992-1996	1997-1998	1999-2001
Aggregate	5.8	3.0	3.5	1.8
Crops	7.4	3.4	3.7	3.4
Staples	8.0	3.8	2.8	3.2
Other Crops	3.9	0.6	6.5	3.3
Livestock	0.9	2.5	0.5	2.7
Fishery	-13.2	3.1	6.8	3.8
Forestry	2.6	1.9	0.6	1.7

Source: Calculated from CBN Data.

Table 2: Nigeria: Average Rate Growth of Industrial Production

Period	Manufacturing	Mining	Electricity	All Sectors
1990-1992	2.0	2.1	5.6	2.1
1993-1995	-8.4	3.2	3.1	-1.3
1996-1998	-1.7	2.3	-2.8	0.8
1999-2001	3.1	7.4	1.8	6.1

Source: Computed from CBN data.

Table 3: Nigeria: Average Manufacturing Capacity Utilization Rates, 1975 – 2001 (%)

Year	Capacity Utilization (CU)
1975	76.6
1976	77.4
1977	78.7
1978	72.9
1979	66.8
1980	70.1
1981	73.3
1982	63.6
1983	49.1
1984	42.0
1985	37.1
1986	38.9
1987	40.4
1988	41.5
1989	42.5
1990	39.0
1991	39.4
1992	40.4
1993	36.2
1994	30.4
1995	29.3
1996	34.7
1997	34.2
1998	32.4
1999	35.9
2000	36.1
2001	39.6

Source: CBN. Annual Report and Statement of Accounts, Various Issues

3.2 Monetary and Financial Sector

The monetary authorities have tried to control inflation over the last four years. The inflationary spiral is

due to expansionary fiscal spending and rapid growth of money and credit. The three tiers of government have spent exorbitantly during the last four years. During the period 1999 – 2001, the growth in monetary aggregate was excessive and grossly out of line with the prescribed targets. The expansion (see Table 4) was induced by the monetisation of excess crude oil receipts, savings and monetary financing of Federal Government fiscal deficits.

Broad money supply (M2) increased by 27.0% in 2001 as against the 12.2 per cent stipulated target for the fiscal year and 47.1% rise in 2000. In the same vein, narrow money (M1) rose by 28.1% compared with the target of 4.3% and the increase of 62.2% recorded in 2000. However, the observed growth between 2000 and 2001 indicates a deceleration (see Table 4). This is due to the various measures taken by the monetary authorities to address the problem of excess liquidity in the banking system.

The credit to the domestic economy for period 1993 – 2001 is presented in Table 4. Credit to government which had drastically reduced by 2000 jumped to almost 80% in 2001 due to the huge fiscal deficit financed by the Central Bank

The increased credit to the private sector is encouraging but it seems that the increase is caused by persistent demand pressure in the foreign exchange market. The increased credit to the private sector ought to influence investment with positive results in real output o. the economy.

The structure of interest rates can influence the developments in the monetary and financial sector. For example, the Central Bank continues to fine-tune the rediscount rate to influence both the bank deposit and lending rates. In June, 2001 the rediscount rate was increased to 18.5%. A detailed analysis of interest rate

management in Nigeria is in (Ekpo, 2001, pp. 1-23).
It is interesting to note that real interest rate remained negative for most of the period 1970-2001. From 1970 to 1984 (with the exception of 1972-74 and 1982), real interest rates were negative. During the period, the economy was characterized by oil windfall and reasonable growth in GDP. Between 1992 and 1996, a period of guided deregulation, real interest rates remained largely negative, ranging from –8.44 to –52.01. These episodes of negative real interest rates confirm the inconsistency between savings and investment in the Nigerian economy. In addition, it gives credence to the fact that interest rates have no influence on savings and that policy should be directed at increasing incomes if saving is to be enhanced.

Table 4: Nigeria: Growth of Money and credit to the Economy 1993-2001 (%)

Year	Net Domestic Credit	Net Credit to Govt.	Credit to the Private Sector	Narrow Money (M1)	Broad Money (M2)
1993	6.27	89.1	19.9	57.5	54.0
1994	34.3	21.6	72.8	46.7	36.3
1995	22.0	7.7	49.4	15.4	18.8
1996	-25.8	-61.6	23.3	18.0	19.1
1997	-2.8	-53.5	23.9	18.2	16.9
1998	46.8	144.9	27.4	20.5	23.3
1999	30.1	32.0	29.2	18.0	31.7
2000	-25.3	-170.1	30.9	62.2	48.1
2001	75.8	79.7	43.5	28.1	27.0

Source: CBN: Annual Report and Statement of Accounts, Various Issues.

Table 5: Nigeria: Nominal and Real Interest Rates and Rates of Inflation, 1970-2002(%)

Year	Nominal Lending Rate	Rates of Inflation	Real interest Rates
1970	7.5-8.0	13.8	-6.3
1971	10.00	15.6	-5.6
1972	10.00	3.2	6.8
1973	10.00	5.4	4.6
1974	10.00	13.4	-3.4
1975	9.00	33.9	-24.9
1976	10.00	21.2	-11.2
1977	6.00	15.4	-9.4
1978	11.00	16.6	-5.6
1979	11.00	11.8	-0.8
1980	9.50	9.9	-0.4
1981	10.00	20.0	-10.9
1982	11.75	7.7	4.5
1983	11.50	23.2	-11.7
1984	13.00	39.6	-26.6
1985	11.75	5.55	6.25
1986	12.00	5.4	6.6
1987	19.20	10.2	9.0
1988	17.60	38.3	-20.7
1989	24.60	40.9	-16.3
1990	27.70	7.5	13.2
1991	20.80	13.0	7.8
1992	31.20	44.5	-13.5
1993	18.32	57.2	-38.98
1994	21.00	57.0	-36.00
1995	20.79	72.8	-52.01
1996	20.86	29.3	-8.44
1997	20.92	8.5	-12.42
1998	21.80	10.8	11.00
1999	27.20	6.6	20.60
2000	30.00	6.9	23.7
2001	24.00	18.9	5.1
2002	24.00	20.2	3.8

Source: CBN Statistical Bulletin, Various Issues.

3.3 The External Sector

The performance of the external sector since independence has been mixed. Since the favourable balance of trade position was reversed in the mid – 1970s the external sector has remained volatile to both internal and external shocks except during the period 1999 – 2001. The pressure on the economy's external sector moderated in 1996 resulting in a lower deficit of N195,216.3 million. This development was due to a favourable merchandise trade account. During the period, the country's external reserves could accommodate import commitments for about four months.

In 2001, the external sector's performance was average. The overall balance of payments was in surplus to the tune of N51.1 billion (US 459 m); the available external reserves could finance 10.5 months worth of imports. The buoyant balance of payments situation was due to favourable external factors such as the high world prices of petroleum , among others. (Iyoha, 2002, p.17; CBN, 2001).

Another disturbing variable in Nigeria's development matrix is that of the high debt overhang. It has been difficult to obtain external debt relief partly due to the contention that Nigeria has not addressed seriously the need for economic reforms. The country has met almost all the conditions to qualify for debt relief under the heavily indebted countries initiative but because of the huge oil resource and the way the economy is managed, no progress has been made.

Table 6 provides data on significant debt measures. Before 1980, the country really did not have an external debt problem. Beginning 1981 debt situation deteriorated. In 1989, the external/GDP ratio was almost

107%; it reduced to about 71% in 1994 and jumped to almost 81% in 1999. Thereafter, it declined to almost 58% in 2001. The situation must be reversed in order to free resources for national development. It is anticipated that the management of the debt will not last for too long. The external debt stock should be reduced to about 5% of GDP. It seems progress has been made in reconciling the country's external debt with the Paris Club.

Table 6: Nigeria: Domestic and External Debt As % of GDP, 1980 – 2001

Year	Domestic Debt/GDP	External Debt/GDP	Total Debt/GDP
1980	16.2	3.7	19.9
1981	22.1	4.6	26.7
1982	29.0	17.1	46.1
1983	38.9	18.5	57.4
1984	40.4	23.3	63.6
1985	38.6	23.9	62.5
1986	38.9	56.7	95.7
1987	33.8	92.6	126.4
1988	32.4	92.4	124.6
1989	20.9	106.9	127.9
1990	32.3	114.6	146,8
1991	35.9	101.2	137.1
1992	29.4	99.0	128.4
1993	37.5	90.8	128.3
1994	37.3	70.9	108.2
1995	17.2	36.2	53.5
1996	12.2	21.9	34.0
1997	12.5	21.0	33.5
1998	19.4	22.9	41.3
1999	22.9	80.7	105.6
2000	18.6	64.0	82.6
2001	18.5	57.9	76.4

Source: CNB Annual Report and Statement of Accounts, Various Issues

4. TREND IN KEY ECONOMIC INDICATORS

The rate of inflation which remained at 70% in 1994 dropped to single digit (8.5%) in 1997. It declined further to 6.6% in 1999. However, in 2001 inflation rose to almost 19% against the background of measures taken by the monetary authorities to mop up excess liquidity. The present inflation has been driven by both demand-pull and cost-push factors. The demand-pull factors include:

- expansionary fiscal policy by all tiers of government
- rapid monetary growth
- large wage and salary increases

The cost-push factors propelling inflation are:

- Fuel price increases and/or fuel scarcity leading to structural inflation
- Inadequate and poor infrastructural services
- Supply constraints resulting from ports congestion.

It is important that government shows fiscal prudence as uncontrolled fiscal activities no matter how they are financed will crowd out investment. There is need for effective co-ordination between the monetary and fiscal authorities.

An uncontrollable inflation will result in macroeconomic instability which will further reduce the already low rate of economic growth with implications for poverty reduction.

The rate of unemployment should be interpreted with caution. Available data suggest full employment but there exists large pool of people who are underemployed. Moreover, not too many job seekers utilize the labour exchanges."

The investment/GDP ratio has been consistently low from 1989 to 2001. This is not surprising given the dearth of foreign private investment in the economy. The savings-investment gap must be narrowed if the economy is to be

on the path of sustained growth and development. The data in Table 7 and previous analysis show an economy in a recession in the last four years. Most of the economic fundamentals are moving in the wrong direction.

It is, therefore, important that measures be put in place to reverse the negative trend and put the economy on the path of sustainable growth and development with minimal inflation. This is one of the challenges of macroeconomic management in Nigeria.

Table 7: Nigeria: Selected Economic Indicators for Selected Years (%)

Year	P	U	Y	I/GDP	DEF/Y
1960	6.0	2.4	4.8	5.0	-1.53
1970	13.0	4.8	5.7	5.4	8.41
1971	15.6	5.3	6.2	6.3	0.50
1975	33.9	4.8	6.0	15.2	1.97
1979	9.9	10 4	1.6	16.5	6.6
1980	20.0	7.8	-0.8	17.9	3.9
1983	23.2	3.4	6.7	14.6	5.9
1985	5.5	8.2	-3.4	7.1	4.9
1987	10.2	7.1	4.2	6.2	5.4
1992	44.4	3.2	3.6	4.1	7.2
1993	57.2	5.4	2.9	3.8	15.5
1994	70.0	2.2	1.0	4.2	7.7
1995	72.8	1.8	2.7	5.1	0.1
1996	29.3	3.8	3.2	5.2	1.8
1997	8.5	3.6	3.8	5.4	-0.2
1998	10.0	3.2	2.4	5.3	-4.7
1999	6.6	3.0	2.6	4.9	-8.5
2000	6.9	3.6	3.8	5.4	-2.1
2001	18.9	3.5	3.9	6.3	-4.0
2002	20.2	3.8	-	-	-

Notes:

P = rate of inflation; u = unemployment rate; Y = growth of GDP

/GDP = investment/GDP; $_{DEF}$/Y = overall deficit/surplus/GDP

Source: Central Bank of Nigeria. Annual Report and Statement of Accounts, Various issues

6. SELECTED ISSUES AND CHALLENGES IN MACROECONOMIC MANAGEMENT

Macroeconomic policy management refers to the set of economic measures, policies and strategies adopted and implemented by an economy to move it from its present macroeconomic state to a more desirable one. This involves the formulation and implementation of measures and policies to achieve short-run macroeconomic stability as well as a rapid diversified, self-reliant and sustainable growth in the long-run.

According to Obadan and Iyoha (1996), the leading issues in macroeconomic management in Nigeria include:

- the macroeconomic policy environment
- the macroeconomic policy mix
- the choice between fixed and flexible target approaches
- obtaining reliable data for macroeconomic policy making.

By macroeconomic policy environment is meant the nature and content of the policy and institutional setting within which government can attempt to tackle the twin problems of short-run macroeconomic stability and rapid growth and development in the long-term. There must be a good macroeconomic policy setting which is dynamic. Such an environment should consist of an optimal mix of appropriate policies, strategies, programmes and institutions.

The macroeconomic policy mix involves the consideration of key macro and several policy issues and

measures guiding the formulation and implementation of government policy. Consequently, the optimal combination of fiscal, monetary and financial, trade and commercial exchange rates, debt management and balance of payments policies to be adopted by government need to be determined. More often an optimal mix of fiscal and monetary policy instruments are considered in trying to fine-tune the economy.

Considering the theory of policy, government could employ a fixed target rule in which instruments are paired with targets and all targets are achieved at the same time, bearing in mind that the number of targets equates the number of instruments. Alternatively, government could use the flexible target approach in which a preference function is specified with levels of target variables as arguments. The approach to be used poses a challenge to policy-makers. However, the fixed target rule has the advantage of placing precise quantitative information about the structural parameters of the economic system.

Another challenge to macroeconomic policy framework in Nigeria is the paucity of accurate, reliable and timely data, inadequate data seriously constrains macroeconomic policy analysis. It makes it difficult to monitor projects and hampers proper implementation. It affects forecasting and overall fine-tuning of the economy. There has been some improvement on data collection

One of the challenges of economic management in Nigeria rests on how to design and implement policies for rapid economic growth in the medium and long-term. If the economy does not grow in real terms by at least 7%, poverty eradication will remain an illusion. It is necessary to put in place policies that will increase savings and promote investment. In this regard the recently announced national savings certificate is pertinent.

It seems apparent that a robust macroeconomic policy framework will thrive better under a deregulated environment. However, policy-makers need to be cautious in deregulating all aspects of the economy. Based on lessons of experience, guided de-regulation of certain aspects of the economy should be experimented. For example, trade liberalization if total cannot benefit the economy. Therefore, policy-makers must weigh the practical issues regarding trade liberalization. The recent WTO experience confirms the importance of being cautious (Ekpo, 2003).

The following issues need to be examined in considering an appropriate macroeconomic policy framework for Nigeria:

(i) the issues of optional deregulation of the economy, and particularly the external sector.
(ii) the issue of the appropriate or optimal exchange rate.
(iii) the question of appropriate interest rate levels
(iv) optimal size of the public sector and the rate of privatization
(v) environmental and ecological problems
(vi) how to mobilize more revenue for sustainable development
(vii) examining the link between budgetary operations and monetary policy
(viii) public expenditure reforms
(ix) the underground economy particularly informal finance
(x) poverty reduction being endogenized within any macroeconomic policy framework.
(xi) Fiscal federalism for example deficits at the lower levels of government may create problems for the under economy;
(xii) Social capital; the significance of networking and community based development organization in influencing growth; and
(xiii) Relationship with the Bretton Woods Institutions (BWIs); we cannot deny the fact that the recommendations of the BWIs may reflect the realities of our economy yet we need their support especially in seeking international credit for development.
(xiv) Budgetary processes; do we continue with the incremental budgetary system that does not emphasise input-out relationship?

6. EFFECTS OF FISCAL AND MONETARY POLICY

We have discussed the performance of the economy based on the utilization of policy instruments. Egwaikhide (2003) using a modified St. Louis framework investigated the relative potency of fiscal and monetary policy actions on economic activity. He regressed the growth of GDP on the distributed lags of the growth rates of government expenditure, money supply and exports for the period 1970 – 2001 (annual data). The results appear interesting. For the period, the cumulative effect of fiscal policy was negative implying that government expenditure did not contribute to output.

The bulk of the government's expenditure during the period may have been wastefully substantial. Comparatively, monetary policy variable exerts a strong positive effect on economic activity and the summed impact of the monetary actions is significantly non-zero at the 5% level. Also, the spread effect of monetary policy lasts for a longer period. This suggests that monetary policy has a greater impact on national income than government expenditure in Nigeria ......" (Egwaikhide, 2003, p. 17).

The result confirms the unhealthy dominance of fiscal policy over monetary policy. However, there is a strong link between fiscal policy and monetary developments in Nigeria.

Theoretically, the link derived from the method of financing budget deficits. It has been shown that substantial borrowing from the banking system by the federal government to finance its deficits has largely expanded the growth of credit. From table A4, it is clear that bank credit to the government exceeded the targets in the various budgets. Therefore, monetary policy will always be in disarray in Nigeria so long as the fiscal authority does not adhere to budget discipline.

In addition, increased government spending increases the income of the private sector and hence the demand for goods and services. The increase in bank credit shifts aggregate demand which results in increased price level. If the expenditure is not checked, no matter how it is financed, it may result in uncontrollable inflation.

5.1 Is Policy Still Relevant?

This question is examined in the context of the inflation cum unemployment trade-off. Using time series data for the period 1970-2002, we estimated an extended Phillips equation of the form:

$$P_t = a_1 + a_2 U_t + a_3 P_{t-1} \qquad (1) \quad a2<0 \qquad a3>0$$

Where:

P_t = rate of inflation

U_t = rate of inflation

P_t = expected rate of unemployment

t = time period

Equation (1) implies that for a given expected inflation rate, there will be a negative trade-off between unemployment and inflation rate. When the expected inflation rate varies, then actual inflation rate (P) will be different for any unemployment rate resulting in a shift in the short-run Phillips curve.

Using ordinary least squares the estimated result is provided thus; (t scores are in parenthesis)

$$P_t = 2.183 - 0.3022U_t + .369P_{t-1} \quad (2)$$
$$(2.564) \qquad (-.806) \qquad (2.072)$$
$$R_2 = 7.20; \; DW = 1.7$$

The unemployment variable has the expected sign but statistically not significant. A 1% decrease in unemployment would result in 0.30% increase in the rate of inflation. Even in the long-run, policy is still relevant - the coefficient of the expected rate of inflation is less than one.

This has policy implication; it means that government can decide where to be on the long-run Phillips curve by putting in place proper policies and strategies. This results contradict that of (Ekpo, 1992) in which an estimated Phillips curve for the period 1978 –1990 indicated that in the long-run there was no trade-off between the rate of inflation and the rate of unemployment.

7. CONCLUSION

We have examined the issues and challenges bordering on macroeconomic policy framework in Nigeria. The evidence indicates that the use of policy instruments has not impacted positively on the economy. The performance of the real sector was dismal while economic fundamentals seem to move in the wrong direction. Leading issues in macroeconomic management in Nigeria include the policy environment, macroeconomic policy mix, the choice between fixed and flexible target approaches and obtaining reliable data policy making.

Within the context of macroeconomic policy framework the challenges include an optimal size of the public sector, the underground economy, poverty reduction, an appropriate exchange rate regime, fiscal federalism and the question of optimal deregulation of the economy, among others.

It is evident from the analysis that public expenditure had impacted positively on output. Fiscal policy dominance over monetary policy needs to be checked.

A robust macroeconomic policy framework must examine the essential features of the Nigerian economy. From this perspective, it may be more useful to model the economy from the stance of disequilibrium.

REFERENCES

Burns, Arthur and W. Mitchell (1946): Measuring Business Cycles, New York, MBER.

Central Bank of Nigeria Annual Report and Statement of Accounts, Various issues.

Ekpo, A. H. (1992) "Economic Development Under Structural Adjustment: Evidence from Selected West African Countries" Journal of Social Development in Africa, Vol.7, No.1, pp. 25 – 43.

Ekpo, A. H (1992b) "Unemployment and Inflation During Structural Adjustment: The Nigerian Experience" Eastern Africa Economic Review, Vol.8, No.2, pp. 102 – 113.

Ekpo, A. H. (1995) "Openness and Economic Performance in Nigeria: A Time Series Analysis" in External Trade and Economic Development in Nigeria, Nigerian Economic Society, Ibadan.

Ekpo, A. H. (1997) "Foreign Private Investment in Nigeria: Evidence From True Series Data" Economic and Financial Review, Vol.35, No.1, March, pp. 59 – 78.

Ekpo, A.H. (1999) "Public Expenditure and Economic Growth in a Petroleum-Based Economy: Nigeria, 1960-1992" South African Journal of Economic and Management Sciences, Vol.2, no. 3, September, pp. 374 – 389.

Ekpo, A. H. (2002) Poverty-Oriented Budget Design and Implementation, AERC 5th Seminar Policy Seminar, Dar-es-Salaam, Tanzania, February.

Ekpo, A. H. (2001) Managing The Nigerian Economy in the 21st Century, IPPA Distinguished Lecture, University of Calabar.

Ekpo, A. H. (2001) "Interest Rate Management in Nigeria: Lessons From Conceptual and Empirical Reviews "Policy Analysis Series, NCEMA, vol.7, no. 2. pp. 1 – 24.

Ekpo, A.H. (2003) Government Revenue Implications of Trade Liberalization in African, WECa, Addis-Ababa, Ethiopia, September.

Iyoha, M. (2002): "Review and Appraisal of the 2002 Federal Government Budget Performance" Bullion, vol.26, No. 2. pp. 14 – 21.

Obadan, M. and M. Iyoha (1996) Macroeconomic Policy Analysis, NCEMA, Ibadan.

Onimode, Bode (2000) Africa in the World of the 21st Century Ibadan, Ibadan University Press.

Sobel, Joel (2002) "Can we Trust Social Capital?" Journal of Economic Literature, Vol. DL, NO.1, March, pp. 139-154

APPENDICES

Table A1: Nigeria Social Indicators, 1991 – 2001

Year	YN	Pn%	LF	ALR%	HDI
1991	1069	2.1	51	54	0.328
1992	1066	3.2	52	554	0.328
1993	1069	2.1	52	55	0.389
1994	1060	2.1	52	55	0.384
1995	1041.5	2.1	52	57	0.402
1996	1051.8	2.1	52	57	0.400
1997	1048.4	3.0	53	57	0.400
1998	1041.0	3.0	54	57	0.400
1999	1038.8	3.0	54	57	0.400
2000	1046.8	3.0	54	57	0.400
2001	1062.5	3.1	54	57	0.400

Source: CBN. Annual Report and Statement of Accounts, Various Issues

Notes:

Y_n = GDP per capita in Naira
P_n = Population growth rate
LF = life Expectancy of birth (year)
ALR = Adult literacy rate
HDI = Human Development Index

Table A2: Nigeria: Average Growth Rate of GDP (%)

Period	GDP at 1984 Constant Price	Agric GDP
1960 - 1965	4.9	1.8
196 - 1970	6.3	2.0
1971 - 1975	8.4	-1.5
1976 - 1980	4.0	2.9
1981 - 1985	-5.7	4.9
1986 1990	5.6	5.3
1991 - 1998	2.3	3.2
1999 - 2001	2.5	2.6

Source: Computed from Data derived from Federal Office of Statistics, Lagos.

Table A3: Nigeria's Fiscal Indices, 1970-2001

Year	Federal Budget Balance	Deficit/GDPRation %
1970	-0.5	-8.7
1971	0.2	2.6
1972	-0.1	-0.8
1973	0.2	1.5
1974	1.8	9.8
1975	-0.4	-2.0
1976	-1.1	-4.0
1977	-0.8	-2.4
1978	-2.8	-7.8
1979	1.5	3.4
1980	-2.0	-3.9
1981	-3.9	-7.7
1982	-6.1	-11.8
1983	3.4	-5.9
1984	-2.7	-4.2
1985	-3.0	-4.2
1986	-8.3	-11.3
1987	-5.9	-5.4
1988	-12.2	-8.4
1989	-15.1	-6.7
1990	-22.1	-8.5
1991	-35.8	-11.0
1992	-39.5	-7.2
1993	-107.7	-15.5
1994	-70.3	-7.7
1995	1.0	0.1
1996	32.0	1.6
1997	-5.0	-0.2
1998	-133.4	-4.8
1999	-285.1	-8.9
2000	-103.8	-2.1
2001	-221.1	-4.0

Source: Central Bank of Nigeria. Annual Report and Statement of Accounts, Various Issues.

Table A4: NIGERIA: Monetary and Credit Growth Target and Budget Out-Turns (%)

Year	M1 Target	M1 Out-turn	Aggregate Credit Target	Aggregate Credit Out-turn	Credit Govt. to Target	Credit to Govt. Out-turn	Credit to Private Sector Target	Credit to Private Sector Out-tur
1987	11.8	17.1	4.4	14.3	1.5	14.4	8.4	14.1
1988	15.0	43.6	8.1	22.2	2.5	30.0	13.3	21.6
1989	14.6	21.5	9.5	-14.1	8.3	-33.5	10.7	3.9
1990	13.0	44.9	13.5	17.1	10.9	14.9	15.8	78.4
1991	14.6	32.6	10.6	45.3	0.0	82.9	16.4	23.7
1992	24.3	6.4	13.2	73.6	14.5	109.7	20.0	34.6
1993	20.0	54.6	17.5	75.9	14.5	121.7	20.0	51.6
1994	21.0	47.8	9.4	29.2	0.0	9.5	32.2	32.2
1995	9.4	8.1	11.3	12.4	5.6	-8.6	21.9	51.8
1996	14.5	26.3	12.0	5.0	0.0	-10.1	29.5	21.9
1997	13.5	16.3	24.8	95.0	0.0	58.0	45.4	20.0
1998	10.2	20.5	24.5	46.8	0.0	144.9	33.9	27.4
1999	4.1	19.9	18.3	35.5	10.2	7.1	199	27.3
2000	9.8	62.2	27.8	-23.1	37.8	-162.3	21.9	30.9
2001	4.3	28.1	15.8	75.8	2.1	79.7	22.8	43.5

Source: Egwaikhide, Festus (2003) Fiscal Policy Management and Its Effects on the Nigerian Economy. Nigerian Economic Society One-Day Seminar, May 22, p. 19.