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Original Article

Fiscal Policy Implementation in Nigeria: Issues & Challenges

Bredino Samson[1], Fiderikumo Peter[2], Adedoyin Adesuji[3]

[1]*Department of Economics, Faculty of Social Science, University of Port Harcourt, Rivers State, Nigeria*
[2] *School of Commerce and Management, Bayelsa State Polytechnic, Aleibiri, Nigeria*
[3] *Department of Industrial and Systems Engineering, University of Pretoria, Republic of South Africa*

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Abstract *- Although a sizeable number of articles on fiscal policy tends to support the notion that fiscal policy has the potency to boost sustainable economic development, this may not necessarily be true in all cases. This paper adopts a conceptual approach to examining the effectiveness of fiscal policy in Nigeria. The intrinsic factors or conditions for the effectiveness or otherwise of fiscal policy as put forward by the IS-LM framework were analyzed vis-à-vis the extrinsic or social-economic peculiarities in Nigeria. Findings reveal that factors such as over-dependence on oil revenue by the Nigerian government, fiscal indiscipline, bureaucratic corruption, and poor governance reduce the effectiveness of fiscal policy in achieving targeted macroeconomic objectives.*

Keywords *- Fiscal policy, IS-LM framework, Macroeconomic objective, Conceptual approach.*

1. Introduction

The campaign for the entrenchment of an interventionist approach to resolving economic problems was led by John Maynard Keynes. Unlike the classical economists, who believed that manipulating the components of aggregate demand and supply is the fulcrum upon which every economic system rests. Thus, Keynes advocated using taxation and expenditure instruments to regulate the economy.

Fiscal policy can be defined as the use of taxation and expenditure by the government to achieve specified macroeconomic objectives such as; full employment, price stabilization, the balance of payment equilibrium, economic growth, etc. Recall that taxation is a compulsory levy imposed by the government for which failure to pay attracts a penalty. Therefore, only the government can formulate and implement fiscal policy from the preceding. Though the efficacy of taxation and expenditure to achieve the macroeconomic objectives in developing countries is debatable, it remains an indispensable and predominant policy tool deployed by most economies. The use of fiscal policy instruments (taxation and expenditure) could have intended and desired effects and unintended but desired effects. For instance, assume that the macroeconomic target of the government is the reduction of unemployment through increases in public expenditure and reduction of taxation. Theoretically, the expansion in expenditure will most likely increase employment via the increase in aggregate demand through the multiplier effect. However, the increase in employment will be accompanied by inflation. From the example mentioned above, though the intended target is reducing unemployment, the unintended effect is inflation. This is the popularly known "Philips curve," which stipulates a negative relationship between unemployment and inflation rate. It is, therefore, imperative for policy formulators to identify all possible effects and fallouts of the implementation of economic policies [1]

Despite the theoretical appeal of the potential of fiscal policy in achieving key macroeconomic objectives and moving the economy from less to a more desirable state, the reverse has been the case in Nigeria. The above stance cannot be overemphasized when you look at the episodic rise in public expenditure at all levels of government accompanied by a rise in unemployment (which is contrary to a priori expectation). A close look at the structure and pattern of expenditure in Nigeria shows that there has been a steady increase in Government expenditure over the years. For instance, total expenditure increased from N701,059 million in 2000 to N4,199,429 in 2010. The rate of unemployment still soared despite increases in public expenditure. [2], posited that the increase in expenditure did not reduce unemployment because a greater percentage was spent on recurrent items instead of capital projects.

The persistent rise in Nigeria's debt is a testament to the high fiscal indiscipline and poor public fund management. Nigeria's outstanding debt was N3,995,638 million in 2000 and rose steadily until 2006. It then fell to N3,177, 409 due to the Nigeria and Paris debt cancellation in [3].

1.1. IS-LM Model in Fiscal Policy Analysis

From an economic perspective, there are set parameters upon which the relative effectiveness or otherwise of fiscal and monetary policy can be analyzed.

This analysis is done using the IS-LM framework. The IS curve defines the interest rate and income at which the

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product market is at equilibrium. Put differently, and it identifies the actual interest rate and income at which aggregate supply equals aggregate demand. On the other hand, the LM is the locus of the combination of interest rate and income at which the money market is at equilibrium, i.e., the point at which demand for money equals money supply. The analysis of the fiscal policy using the IS-LM framework is seldom done absent the money market. This is because the magnitude of the impact of the multiplier effect on the output of an increase in investment expenditure is dependent on the rate of sensitivity of interest rate to investment [4].

Thus, to preclude any deviation from the study subject, we shall only consider the geometric approach to analyzing the relative effectiveness of the fiscal policy. However, we shall refer to monetary policy implications where unavoidable.

1.2. Geometric Analysis of the Effectiveness of Fiscal Policy

Given the assumptions of a fixed or constant money supply, fiscal policy can be strong if the interest rate is investment inelastic. By interest being investment inelastic, we mean that investment is insensitive to changes in interest rate.

For instance, assuming the government embarks on an expansionary fiscal policy, i.e., an increase in government expenditure and a reduction in taxation. This will lead to an increase in aggregate demand depicted by a rightward shift of the IS curve from IS_1 to IS_2. The increase in aggregate demand will cause an increase in demand for money for the transactional purpose. This will distort or bring about disequilibrium in the money market (the monetary sector), given that the money supply is fixed. Thus, the interest rate will rise to restore equilibrium in the money market. However, investment expenditure will be unaffected by the rise in interest rate because investment is very insensitive to the interest rate. This means that the positive impact of government expenditure will be unaffected by the increase in interest rate. This is illustrated in figure 1.1 below.

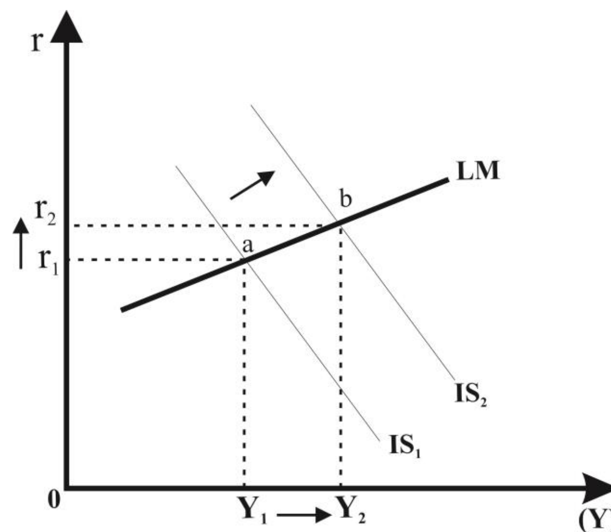

Fig. 1 IS-LM Model showing Strong Fiscal Policy

Fiscal policy can be strong if the LM curve is flat. A flat LM means that the rate of sensitivity or response of money demand to the interest rate is very high. Put differently, a small change in money demand will result in a more than proportionate change in interest rate. Assuming there is an expansion of aggregate demand due to an increase in expenditure. This will necessitate an increase in demand for money for the transactional purpose. But, this creates a distortion in the money market given the assumption that the money supply is constant. Therefore, the interest will need to be reviewed upwards to restore harmony in the market, i.e., the equality of demand and supply of money. Because the responsiveness of money demand to interest is very high, only a very slight change in interest rate will be required to equilibrate the money market. Again, the slight change in interest rate will not significantly offset the positive impact of government expenditure on the economy.

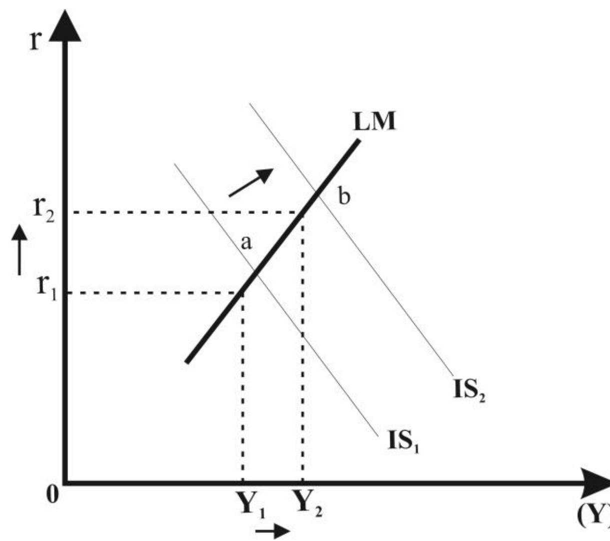

Fig. 2: IS-LM Model showing Weak Fiscal Policy

The complexity inherent in the process of fiscal policy operations and its attendant macroeconomic outcomes makes it difficult to capture its effects on economic growth truly. Bearing in mind that fiscal policy is usually used in conjunction with other economic policies like trade, monetary, etc. [5]. Some empirical studies on the effects of fiscal policy have attempted to adopt a cause and effect approach to determine its relative effectiveness. A case in point is the study of government institutional frameworks such as corruption, economic freedom, and democracy and their impact on selected macroeconomic variables such as employment, economic growth, and the balance of payment [6],[7].

2. Oil Revenue Uncertainty

Oil revenue volatility and uncertainty are major inhibiting factors to the effectiveness of fiscal policy in Nigeria [9].

This is a result of the failure of policy formulators to consider the exhaustibility of natural resources and their implication on macroeconomic stability. Nigeria derives 75% of its revenue from oil and gas, and thus, its fiscal policy has been largely affected by oil price volatility. Consequently, government revenue and expenditure, and by extension, the entire economy, have been heavily affected by oil-driven volatility.

It has been argued that the persistent budget deficits and increased demand for loans (both internal and external) by the government are partly due to shocks in the price of oil in the international market coupled with the country's unwillingness to galvanize other non-oil revenue sources. The inability of Nigeria to meet its annual projected high oil revenue upon which its budget is made portends huge challenges to fiscal operations. Accordingly, the country will resort to funding the budget deficit by borrowing or printing more money, thereby expanding the money supply. This will consequently increase the interest rate and reduce investment.

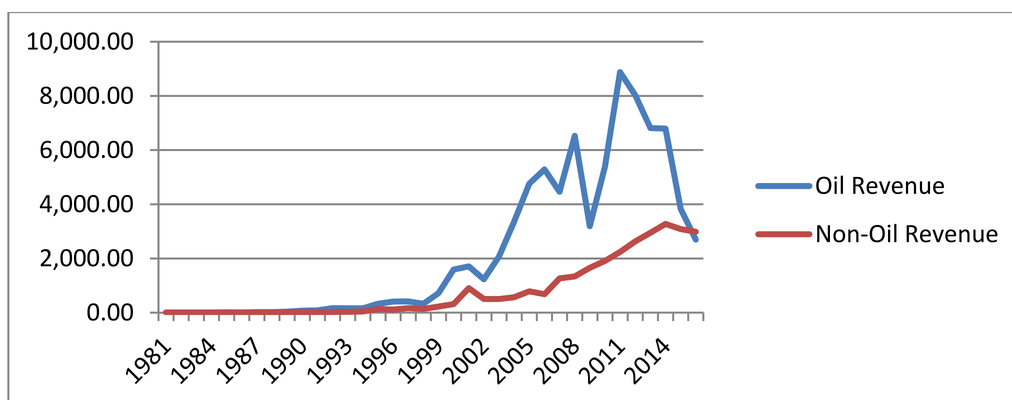

Fig. 3 Nigeria's oil and non-oil revenue (1981 – 2016)

Source: CBN Statistical Bulletin

As seen in figure 1.0 above, there has been sustained growth in government revenue from oil and non-oil sources within the period under review. However, the oil revenue tends to grow faster than non-oil revenue.

3. Absence of Fiscal Discipline

Literature on public finance is replete with various definitions of fiscal discipline. Richard Musgrave postulates fiscal discipline as financing government expenditure from current revenue. In other words, fiscal discipline is the absence of deficits and avoidance of borrowing to finance current government expenditure demand [20].

It is rare to find a developing economy that does not incurr a budget deficit or resort to borrowing when the occasion demands. A budget deficit is necessary for periods of economic recession as it tends to boost aggregate demand by expanding government expenditure, especially on capital projects. In most cases, it may borrow or increase taxes to augment its expenditure to achieve economic stability. Therefore, as opposed to Musgrave's postulation, deficits and borrowing may not necessarily denote fiscal indiscipline. However, a country can be fiscally indisciplined when it incurs a persistent deficit, especially when there are pieces of evidence that prove that the funds borrowed were not judiciously utilized.

Yet another definition of fiscal discipline was put forward by [11]. In support of Musgraves's definition, he defines fiscal discipline as "limiting spending to accessible and usable funds ."He asserted that government and its agencies have a huge part to play in ensuring that fiscal discipline is enforced by restricting their expenditures to the approved or budgeted funds.

The government's deficit financing through borrowing from the banking sector reduces the effectiveness of expansionary fiscal policy by reducing private access to credit through the resulting rise in interest rate [12]. Therefore, debt and debt financing are indicators of fiscal discipline. Thus, the impact of expansionary fiscal policy in highly indebted countries will be eroded by the rise in interest rate, which will crowd out private investment. A cursory view of Nigeria's deficit and debt profile shows that fiscal indiscipline is prevalent. The above stance has been collaborated by [13], who reiterated that the huge outflow of capital from Nigeria manifests fiscal indiscipline.

4. Corruption

The word "corruption" is one of the most popular vocabularies in Nigeria. To a great extent, most Nigerians tend to correlate every negative economic outcome, such as inflation, a rise in the pump price of petroleum products, industrial strikes, etc., to corruption. The president of Nigeria, Muhammadu Buhari, during his election campaign in 2015, vowed to eradicate corruption, even though recent events show the reverse.

There are two variant views on corruption. The first views corruption as a "virtuous activity" with which countries can stimulate economic growth by eliminating the rigidies or red-tapism associated with government activities. For instance, collecting huge bribes for the allocation of contracts limits the opportunities for an efficient and financially buoyant contractor only. Also, it reduces the lengthy protocol and administrative costs associated with the selection processes.

Recently, the "virtuous view" of corruption has been replaced with a more realistic view. Rather than being the lubricating oil of the economy, it is a cog that slows down its operations. The argument favoring this view is that the processes and procedures adjusted to slow down the processes were formulated by individuals who will stop at nothing to keep it that way as long as it furthers their benefit. Thus, corruption can be defined as the abuse of public power to promote private benefit [14]. The benefits may not necessarily be monetary.

Corruption is a ubiquitous concept bordering on life's social, economic, and political spheres. However, we shall focus our study on the interplay of corruption in the public sector and its impact on fiscal policy operations. The effectiveness of fiscal policy can be affected in two major ways: revenue contraction and expenditure blotting by public officials.

The persistent budget deficit recorded by the government is a result of the leakage effect occasioned by the diversion of tax revenue into the personal accounts of the tax administrators. Thus, increasing the tax burden of the citizens and reducing the funds that are supposed to be used to embark on projects to boost the economy. [21]. Thus, corrupt practices in the public sector restrict fiscal capacity in taxation and increase inflation [16]. Further studies have shown that the GDP share of tax revenue is low in highly corrupt countries. The implication for public policy is that the tax distortion will result from reducing public spending and a higher fiscal deficit. Those mentioned above have been part of why there has been a shortfall in foreign direct investment in the country [17].

The supply of false data by corrupt government agencies and th allies renders fiscal policy operations impotent in achieving macroeconomic stability. For instance, the inability of the Central bank of Nigeria to ascertain certain information, such as Nigeria's external debt, may render its economic model useless because it is based on false information [18].

5. Poor Governance

Governance is a key determinant of the effectiveness or otherwise of fiscal operations because it is an integral part of the economic and financial management framework, which implies macroeconomic stability. Poor governance is characterized by a lack of transparency and inefficient institutional controls. To a large extent, these features will define the modus operandi of public

expenditure and revenue and, by extension, the relative effectiveness of fiscal policy [19].

Corruption is a manifestation of poor governance. There is a high propensity for corrupt practices to thrive when the institutions are inefficient, the government personnel is ignorant and incompetent, and the economic models and ideologies are misguided.

6. Conclusion

Though the fiscal policy has the potency to achieve macroeconomic stability, policy formulators should critically examine its ideological framework vis-à-vis the country's social-economic peculiarities before implementation. This will enable them to capture the unintended and adverse effects and make appropriate plans to facilitate the same. Secondly, th government has to gradually shift its attention away from the oil sector and develop other sectors of the economy, such as agriculture. This will enable it to generate substantial revenue and buffer against shocks emanating from oil revenue volatility. Thirdly, to address the issues of fiscal discipline and corruption in the Nigerian public sector, appropriate structures must be put in place to block revenue leakages and flagrant government spending.

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