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# Impact of Fiscal and Monetary Policy on the Economic Development of Nigeria: Empirical Review

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***ABSTRACT***

*This study seeks to investigate the impact of fiscal and monetary policy on economic growth in Nigeria: Empirical Review from 1991 to 2021. A good government administration and the monetary authorities can be dictated by the good political and economic state of that nation; hence, an economy has the obligation of enhancing its economic growth and development having in mind the end goal, which is to decrease the level of its debt and maintain price stability. From the studies reviewed, a good number concluded that tax and money supply tools, in some certain periods, have negative impact on the output which indicated that the tools used in their studies reduce their effectiveness and the efficiency of the policies. Other studies concluded that although interest rate has decreased dramatically from 1991 up to 2021, the investment and economic growth rate still increase slowly indicating that the effectiveness of these policies is not high. Consequently, it is necessary to increase the efficiency of fiscal and monetary policy via unblocking the transmission channels such as bank network, financial market, and capital market. This study recommends among others that as regards fiscal policy, government may seek economic expansion by increasing spending (without corresponding tax increases) – like building more federal roads, could increase employment, pushing up demand and growth while the central bank can implement a tight monetary policy by raising interest rates and removing money from circulation.*

***Keywords*****:** *Fiscal Policy, Monetary Policy, Economic Growth*

## 1. INTRODUCTION

On the basis of modern economics, fiscal and monetary policies are significant tools to express the government's opinions and orientation for economic growth to the economy. Fiscal policy is implemented using two main tools as tax and the government expenditure. Meanwhile, monetary policy is implemented by the government's control in money supply and even the foreign exchange rate adjustment (Gregory Mankiw, 2007). The fundamental roles of fiscal policy, monetary policy and trade policy cannot be over-emphasized in any open economy, especially in terms of economic management. Notably, the quests to achieve and sustain macroeconomic objectives explain the vital roles played by fiscal, monetary and trade policies in both developed and developing economies, which Nigeria is inclusive. Adeeb (2013) noted that it is the goal of any rational government to improve the living conditions of her populace through major economic policy either through fiscal, monetary or trade policy. Again, these economic policies are mostly used to stabilize and sustain the economic progression, especially during the period of economic crisis. For example, fiscal policy measure is used by government of different economies to counter economic imbalances by adjusting the public spending to moderate taxation which is an important approach to control aggregate demand, financial uncertainty and economic distortions. Keynes posited this approach need to be adopted, especially during economic recession so as to build a stable framework to attain full

employment; hence, this theoretical model had been practically used as policy guide to sustain economic activities over time (Idris, Bakar & Ahmad, 2018). Meanwhile, the classicalists argued for effective price mechanism where efficient and robust resources allocation can guarantee economic freedom that is devoid of government intervention in the cause of addressing economic crisis (Idris & Bakar, 2017). On the other hand, monetary policy is adopted by the Apex Bank of any given economy to stimulate collective demand through adjustable changes in money supply and interest rate. In the time of economic crisis, government combines both fiscal and monetary policies to curb fluctuations of business cycle. In a similar vein, government put in place trade policy with the aim of improving trade relation and builds the necessary safety net against external shocks through stabilized exchange rate.

Over the years, many developing economies have been facing the problem of huge fiscal, monetary and trade deficits, which Nigeria is inclusive. The insufficient and the nature of public goods such as infrastructure and utilities services hugely rely on the rate of government spending, which affect both the nature and condition of macroeconomic framework and fiscal sustainability in any small open economy. Fiscal policy, monetary policy and trade policy in Nigeria are characterized by profligacy, poor financial framework, which is strengthened by poor management of huge oil revenue that pose a threat to macroeconomic stability (Idris & Bakar, 2017). However, in the time past, the Nigerian economic growth has not significantly tapped from those expected gains from trade policies which could have been traced to the mono-economic nature of the Nigerian economy where government mostly relied on oil revenue. This has caused incessant rise in budget deficit in recent times; hence, there is need for policy makers to adopt effective fiscal and monetary measures so as to stabilize the aggregate economic outlook. Notably, a persistent rise in military spending to counter terrorism and additional unproductive outlays might have contributed to slow economic growth in Nigeria. In the meantime, Idris and Ahmad (2017) posit that continuous show of fiscal deficit in Nigeria may be connected to over dependency on gains from oil coupled with external borrowings. Consequently, significant effects of improved fiscal measures would increase aggregate growth which could curb persist ineffective monetary and fiscal policies. It is worth agreeing with the position of Khattry and Rao (2002) which state that trade policy improves fiscal balances through rise in tax revenue. And this is expected to increase the size of government revenue that could be channeled to various productive sectors via government spending on infrastructure.

In lieu of the above narrative on the nexus between fiscal policy and economic growth, or nexus between monetary policy and economic growth, has been observed through studies that increase in government spending and trade openness and decrease in interest rate have not transmitted to improved economic growth in Nigeria. Interestingly, further related studies have equally come up with mixed revelations. For example, Amassoma, Keji and Emma-Ebere (2018), explained that monetary policy is a vital tool which could be used to achieve price stability, and hence strengthen both private and foreign investors that guarantees economic progress in the long. Also, Idris, Bakar and Ahmad (2017) posit that robust and effective fiscal operations guarantee economic growth since any slight distortion in fiscal operation in the form of deficit brings adverse effect on growth rate, which further substantiate the epistemology method of neo-classical theory that posit growth-retarding effects on the general economic performance due fiscal deficit.

With this narrative, it can further be observed that studies on the subject matter in Nigeria have come up with different results, but most of these previous works are not encompassing in terms of linking fiscal policy, monetary policy and economic growth rather most of these works had either attempted to link monetary policy with economic growth or relate fiscal policy with economic growth. It is

interesting to note that this study intends to fill the gap observed from previous studies through empirical investigation into the connection between fiscal policy, monetary policy and economic growth in Nigeria. Going forward, series of questions arise, which this study seeks to address; do fiscal and monetary policies matter on economic growth? What is the link between fiscal and monetary policies and economic growth in Nigeria?

The aim of this study is to empirically review the nexus between the key variables while the outcome from this study would further provide guide for both government and policy makers so as to address the current persistent economic recession in Nigeria.

The reviewed literature clearly shows evidence that there exists a dearth of knowledge as regard how the combined impact of fiscal and monetary policies affects economic growth in Nigeria. In addition, the Nigerian government continues to implement different policies aimed at achieving economic growth and stability but the economy continues to experience a low level of economic growth as indicated by the national bureau of statistics. Consequently, this study hopes to add to the existing literature and give an original contribution to knowledge by examining the impact of fiscal and monetary policies on economic growth in Nigeria so as to suggest viable recommendations to the Nigerian government. This paper is structured into four sections: introduction, literature review, methodology, conclusion and recommendation.

## 2. Literature review

There are various empirical studies conducted in the past which form the existing literature for the subject matter of this study. Previous studies that relate to this study are reviewed and categorized based on how each of the variables affects economic growth in Nigeria as presented in the existing literature. For example, for the review of how fiscal policy affects economic growth, Agu, Okwo, Ugwunta and Idike (2015) examined how fiscal policy affects growth of Nigeria's economy with a focus on the different components of public spending using OLS estimation technique. They found that government spending increase with an increase of revenue generated by the government. The study concluded that the correlation between government spending and growth of the economy is a strong and positive one. Babalola and Aminu (2011) investigated the effect of fiscal policy on Nigerian's economic growth from 1977 to 2009. The study observed that productive expenditure positively influences the country's economic growth. The study therefore recommends that government should improve its spending on economic services, education and the health sector to boost the growth of the economy. Onwe (2014) investigated the growth of Nigerian economy vis-à-vis effect of fiscal policy components on Nigerian economic growth. The study observed the positive impact of federal expenditure on administration as well as on community and social services on growth of the economy. However, it also observed the non-positive impact of federal spending on transfer payments and economic services on the growth of Nigeria's economy. The study recommended a need for federal government to place special emphasis on administrative, social and community services in its fiscal policies because these fiscal components have potential contribution in the development of the Nigerian economy. Mobolaji. Ehigiamusoe and Lean (2015) examined inclusive growth in Nigeria vis-à-vis the role of fiscal policy using a baseline regression model. They found that fiscal policy significantly promotes inclusive growth in Nigeria. The study also observed a unidirectional causal relationship from fiscal policy to inclusive growth in Nigeria. It recommended the need for government expenditure to be directed toward productive investments and infrastructural development in a bid to accelerate inclusive growth.

For a review of how economic growth is affected by monetary policy, Ayomitunde, Olaniyi, Zannu and Stephen (2018) examined how Nigerian economic growth is been affected by monetary policy for the years 1990 to 2017 using an ARDL Bound estimation technique. Findings showed monetary policy rate significantly propels growth of Nigeria's economy in the short run while inflation rate positively influence growth of Nigeria's economy in both the short and long run, there is a significant positive relationship between economic growth and inflation rate. They recommended that Apex Bank use monetary policy variables that help drive economic growth in Nigeria. Onyeiwu (2012) explored how monetary policy affects Nigerian economic growth using OLS estimation technique. The findings showed that monetary policy stimulates gross domestic product cum balance of payment but adversely impact inflation rate. It recommended that monetary policy be used to create an investment-friendly environment and the money market should strive to provide financial instruments that meet the needs of increasingly numerous players. Sulaiman and Migiro (2014) investigated the nexus between growth of Nigerian economy and monetary policy. The study found that monetary policy supports economic growth, and the study also found that economic growth is unrelated to monetary policy. The study concluded that the mechanism for transmitting monetary policy makes a positive contribution to the productivity of the Nigerian economy, thereby improving economic growth. The study recommended that the regulatory framework for the financial sector be strengthened to contribute to the efficiency of the government's monetary policies. Adigwe, Echekoba & Onyeagba (2015) studied how monetary policies in Nigeria affect the country's economic growth using the ordinary least square technique. The study observed that monetary policy promotes economic growth, while it adversely affected by inflation rate. The study recommended using monetary policy to foster an enabling investment environment through appropriate interest rates, liquidity management and exchange rates. Fasanya, Onakoya & Agboluaje (2013) studied the effect of monetary policy on the growth of Nigeria's economy using the error correction model technique. The study found that monetary policy instruments such as the inflation rate, the exchange rate and foreign reserves boost growth in Nigerian economy in line with theoretical expectations while money supply in Nigeria is unrelated to economic growth. Consequently, the study recommended the establishment of primary and secondary government bond markets that would enhance the effectiveness of monetary policy and reduce the government's reliance on the central bank for direct financing.

In addition, there are some studies that examined the combined effect of fiscal and monetary policy on economic growth in Nigeria. For instance, Bodunrin (2016) examined how fiscal and monetary policies affect Nigerian economic growth using vector error correction model technique to determine which of the policies has been more effective in driving the growth in Nigeria. The study observed that in the short-run fiscal policy distort economic growth while monetary policy had no effect on gross domestic product. The study opined that fiscal policy should take the central stage in the use of policy options. Ajayi and Aluko (2017) evaluated how efficient is monetary and fiscal policy in Nigeria employing OLS estimation technique. The study observed that export and money supply growth significantly stimulate economic growth while government spending had no impact. Also, the study found that monetary policy stimulates the growth more than fiscal policy. The study recommended the use of monetary policy by the Nigerian government rather than fiscal policy as an economic stabilization tool. Ishola and Titiloye (2020) examined the effect of fiscal and monetary policies on growth of Nigeria economy using ARDL technique. The study found that supply of money vis-à-vis government spending cum revenue stimulates Nigerian economic growth. The study recommended that there is a need for the government to allow expansionary monetary policy to stabilize economic growth. Adegboyo, Keji and Fasina (2021) examined the impact of fiscal, monetary and trade policies on Nigerian economic growth from 1985

to 2020. This study adopted the endogenous growth model (AK model) as its theoretical framework. According to them the result of the impact of monetary policies shows that interest rate impels growth of the economy while money supply deters growth of Nigeria's economy. Consequence of these findings, the study recommends amongst others that Policymakers should place more emphasis on using fiscal policy which the study found to stimulate the country's growth rate, and whenever it is expedient to use monetary policy to stimulate economic growth, Policymakers should make use of interest rates since it stimulates the growth of the economy in the short run.

## Methodology

The research methodology, research design, sample design, and data collection method employed in this study are all shown in the reviewed studies. The research is based on a descriptive research design which was applied in picking the literatures reviewed on fiscal and monetary policies on economic growth. The target population is based on all research studies conducted all across the globe on the subject matter. The sample is on the subject matter conducted majorly on Nigeria. The review of literature for this study was conducted between 1991 and 2021. The time period is chosen for the sake of convenience sampling. Secondary data was employed as a source of information. Consequently, the literature review was compiled from a variety of research publications available on multiple platforms such as JSTOR, the National Digital Library, Google scholar, research gate, Academia and others.

## Conclusion and Recommendations

The main objective of this study is to evaluate the impact of fiscal and monetary policy on economic development of Nigeria: empirical review from 1991 to 2021. From literatures reviewed, the study suggests that fiscal policy has significantly impacted positively on economic development if government expenditure is treated as the functional fiscal policy instrument rather than the government revenue. This implies that Nigerian government should redirect her public expenditures into investing more in human capital. Investing in human capital, among other factors can include vesting the active unemployed population with relevant skills that meet the labour market demand for easy employment. Hence, tax revenues would more likely increase government revenue which could play an important role in reducing government budget deficits.

The review also shows that monetary policy has positively influenced economic development in Nigeria as drawn from the estimated signs present in the literatures reviewed. This implies that, real interest rate and official exchange rate inclined economic development negatively in the economy of Nigeria. Hence, CBN can make monetary policy more effective by using it to lower interest rates, thereby reducing consumer's cost of borrowing and to reduce individual cost of investment. Due to this, aggregate demand will increase which would consequently lead to a decrease in inventories. Consequently, firms will increase output which in turn would result in an increase in the level of income. This implies that it is necessary to increase the efficiency of monetary policy via unblocking the transmission channels such as bank network, financial market, and capital market. In this regard, it is necessary not to implement policies that may improve the standard of living which can cause positive effect on the level of economic in Nigeria economy. Also, it is necessary to create a transparent direction of policy administration in medium and long term. It should be noted that the long-term consistency needs to be ensured in order for the effective promotion of the policies.

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