MONETARY AND FISCAL POLICY IN NIGERIA: INTERACTION AND COORDINATION

Dr. Arit Beka Etukudoh, Dr. David E. Ezemokwe, Ebiem-kenechukwu Peace, I.
Projects Development Institute (PRODA), Emene, Enugu State, Nigeria.

Abstract

The Monetary and Fiscal Policies, although controlled by two different organizations, are the ways that our economy is kept under control. Both policies have their strengths and weaknesses, some situations favoring use of both policies, but most of the time, only one is necessary. The monetary policy is the act of regulating the money supply by the Federal Reserve Board of Governors, currently headed by Alan Greenspan. One of the main responsibilities of the Federal Reserve System is to regulate the money supply so as to keep production, prices, and employment stable. The "Fed" has three tools to manipulate the money supply. They are the reserve requirement, open market operations, and the discount rate. The most powerful tool available is the reserve requirement. The reserve requirement is the percentage of money that the bank is not allowed to loan out. If it is lowered, banksare required to keep less money, and so more money is put out into circulation (theoretically). If it is raised, then banks may have to collect on some loans to meet the new reserve requirement.

1.0 Introduction

Every economy is faced with the achievement of five major macroeconomic goals viz economic growth and development, price stability, balance of payment equilibrium, exchange rate stability and high employment level. Most governments translate these objectives into short, medium or long term goals. Thus, we have vision 20-20-20 which is a long term goal, transformation agenda which is a medium term goal. The ways and means of achieving these objectives have divided economist into two main schools of thought propounding two main policy options. These are the Keynesians who proposed the use of fiscal policy, and the Monetarists that proposed monetary policy as a way of achieving these objectives. Monetary and fiscal policy make up the macroeconomic policies that largely determine the direction and growth of the economy (Akande, 2013).Monetary policy is the deliberate effort by monetary authorities to control the money supply and credit conditions for the purpose of achieving the above mentioned objectives (Anyanwu, 1997). Fiscal policy, on the other hand, refers to the raising of revenue through taxation and other means, and deciding on the level and pattern of expenditure for the purpose of influencing economic activities or attaining some desirable macroeconomic goals (Anyanwu, 1997). Often in achieving these objectives, most economies use a combination of both policies, which sometimes leads to conflicts

These is a dilemma as to whether they are complementary or substitutes. They are viewed as substitutes when one authority's expansionary (contractionary) policy actions are countered by the other authority's contractionary (expansionary) policy actions. For instance, if the fiscal authorities raises taxes or cuts spending (contractionary), and the monetary authorities reacts by lowering the monetary policy rates (MPR) (expansionary).If they behave as complements, then an expansionary (contractionary) policy of one authority will be met by an expansionary (contractionary) policy by the other e.g. an increase in the tax rates or spending cuts will be matched with raising of the MPR. Which one is coming in Nigeria? The issue of interaction and the policies being

complements or substitutes depends on the level on independence of the fiscal and monetary authorities. If they are independent, then the issue of interaction between the two, and their nature arise. But if one authority dominates, then it solely dominates the policy making and there will be no interaction worthy of analysis. What is the level of dependence (independence) between the fiscal and monetary authorities in Nigeria?Furthermore, the interaction between the two, where it exists, is to the extent of influencing the final objectives. As long as the objective of one policy is not influenced by the other, there is no direct interaction between them (in Nigeria, does the objective one policy influence the other?)Coupled with this is the argument as to whether the government is more efficient than the market in the allocation of resources. This has seen the Nigerian economy going back and forth in her conduct of policies.

The growth of the Nigerian economy has witnessed ups and downs – from a period of oil boom in the early 1980s to economic down turns in the late 1980s. This is mostly attributed to the swings in the price of crude oil which is the main source of revenue for Nigeria. Government policies have oscillated between Keynesian model of government control and the Classical model of relying on market forces with varying degree of success. This often translates to a conflict between monetary and fiscal policy. This manifests in accusations and counter-accusations between the monetary and fiscal authorities. This calls for a look at the interaction and harmonization of the two policies in order to achieve any identified macroeconomic goal of the economy; thereby stabilizing and improving the dwindling fortunes of the Nigerian economy.

This paper is aimed at reviewing the monetary policy in Nigeria, and examining its relationship with fiscal policy especially the implementation of the budget. It is hoped that we will come up with a strategy for better coordination of fiscal and monetary policies in Nigeria for enhanced economic growth and development.

1.1 Monetary Policy in Nigeria

Active monetary policy started in Nigeria in 1958 (Ndekwu). The Central Bank of Nigeria (CBN) is the organ charged with the formulation and implementation of monetary policy in Nigeria. Its core mandate is derived from the 1958 Act of Parliament as amended. The Act charges the CBN with the overall control and administration of the monetary and financial sector policies of Nigeria.The objectives of the CBN which is also its core mandate are:

1. Ensure monetary and price stability
2. Issue legal tender currency in Nigeria
3. Maintain external reserves to safeguard the international value of the legal tender currency
4. Promote a sound financial system in Nigeria; and
5. Act as banker and provide economic and financial advice, to the federal government.

In addition to its core functions, CBN has over the years performed some major development functions, focused on all the key sectors of the Nigerian economy (financial, agricultural and industrial sectors). However, the thrust of monetary policy in Nigeria in the past few years has been the promotion of price and banking stability (Monetary Policy Review, July – December, 2010). In implementing its policies, there is an apparent conflict between the twin objectives of price and banking stability; and stimulating output growth.

Monetary policy can be active or passive. Active monetary policy is a situation whereby inflation is pursued independent of the fiscal policy; while passive monetary policy sets interest rates to accommodate fiscal policy.Monetary policy regimes in Nigeria can be divided into two viz pre, and post-structural adjustment programme (SAP) era. The pre-SAP era was the period before 1986. It was a period that saw the propagation of

the Keynesian policy option of government – managed economy. This also reflected in the monetary policy of that time which was direct control by the government. Interest rate was directly administered by the CBN. According to Anyanwu (1997), the government sets low deposit and lending rates for the financial intermediaries. This led to low interest rate, leading to excessive liquidity outside the banking system. However, high inflation persisted making the real rates of return on savings negative and this discouraged savings. Thus, there was an agreement that finance in Nigeria was highly repressed due to the low (often negative) real rates of return on deposits and loan rates (Ikhide, 1990). This is indicative of financial repression. This further implies that there are limited available loanable funds leading to low investments.However, with the recommendations of McKinnon (1973) and Shaw (1973), there was a shift by most economies towards financial liberalization. Nigeria embraced financial liberalization with the introduction of the Structural Adjustment Programme (SAP) in 1987.In Nigeria, the main features of financial liberalization are the deregulation of interest rates and exchange rates, relaxation of entry barriers, which lead to increase in the number of banks, institutional reforms, capital market deregulation and introduction of indirect monetary policy instruments. Nominal interest rate also increased. However, with the increase in the nominal deposit rate of interest and lending rates, there was no improvement in the real deposit rate, which remained negative even in the period of deregulation. The interest rate spread was still wide all-suggesting inefficiency in the banking system in the face of deregulation.With the increase in the number of banks occasioned by the liberalization, came still competition. The stiff competition led to a lot of risky investment by many banks. This led to the crash of some banks in the face of the liberalization. To sanitize the banking system the CBN under Soludo came up with the consolidation programme which saw the reduction of the number of banks to 25 from 89. The essence of the consolidation was to have few big banks that can undertake efficient financial intermediation. However, this was not to be as another problem emanated. There was low growth of bank credit to the private sector. There was also the challenge posed by the global financial and economic crisis. The need to promote economic growth and financial stability led to the accommodative monetary policy stance which was to be relaxed due to rising inflation.

Then came the new reforms under Sanusi. His was more of risk management. This saw the further collapse of some banks. The reforms saw the frequent use of Monetary Policy Rate (MPR), Open Market Operation (OMO) and Cash Reserve Requirement (CRR) in the operations of monetary policy by the CBN.The inflation rate maintained a double-digit stance in 2011, though it came to as low as 9.2 percent and 9.5 percent in June and September, 2011 respectively (CBN, 2012).This continuous increase in the rate (though there were decreases in between) begs the question as to the efficacy of our monetary policies. The CBN through its Monetary Policy Committee (MPC) puts the blame of the high inflationary trend in Nigeria, not on ineffectiveness of the monetary policies, but at the door of fiscal spending and the global food, fuel and other commodity prices as well as the challenges of financial stability (MPC Communiqué, 2011). Due to this, at the close of the last quarter of 2011, the CBN was determined not to pursue an accommodative policy stance, but a further tightening in 2012.Based on the above, the CBN supported the programme of fiscal consolidation as signalled by the government at the beginning of 2012. Coupled with this is the increased share of capital expenditure in the total expenditure in the 2012 budget. This is aimed at improving the productive capacity of the economy; and ensures a conducive environment for the coordination and cooperation between fiscal and monetary authorities.

Inspite of the monetary tightening by the CBN there seemed to be not much improvement in the macroeconomic indicators especially inflation and employment in 2012. Core inflation rose to 15.2 perfect in June, 2012. According to Toure (2012), the unemployment rate in 2006 was 12.3 percent, which rose to 23.9 percent in 2011 with youth unemployment being 46.5 percent in 2011 (Toure, D. 2012).Inflation rate has been on the downward trend since the beginning of 2013. In July, 2013 Nigeria's annual inflation rate increased to 8.7 percent, from 8.4 percent in June, mainly due to higher food and house prices. The June, 2013 is the lowest since April, 2008. In May 2013, the annual inflation rate dropped to 9 percent. This suggests a success on the part of the monetary authorities, whose main concern is price stability (low inflation). They believe that this can only be achieved through tight monetary policy. Thus, the MPR has continuously be fixed at between 11-12 percent, which translates to interest rate of above 20 percent in the real sector (Akande, 2013). (Does low inflation rate automatically translate to development?)Fiscal Policy: The main objective of fiscal policy is to increase the aggregate output of the economy. It therefore affects the goods market. Fiscal policy could also be active or passive. In passive fiscal policy, taxes are raised or reduced to balance the budget inter-temporarily. For active fiscal policy, the tax and spending levels are determined independent of inter-temporal budget consideration. The government fiscal policy measures can be categorised into two viz the automatic stabilizers and discretionary fiscal policy measures. The automatic stabilizers are government spending or taxation actions that take place without any deliberate government control and which tend to dampen the business cycle. The discretionary fiscal policy is government spending and taxation actions that have been deliberately taken to achieve specific macroeconomic goals.The budget contains details of the fiscal measures of an economy. The implementation of the budget of a nation entails the implementation of the fiscal policy of the country. According to Ekpo and Afangide (2011), fiscal policy affects monetary policy in various ways, viz inflationary process as a result of fiscal expansion requiring monetization; effect on aggregate demand which may be the main determinant of inflation; interest rates; exchange rates and interest spreads. If the fiscal dominance is not checked, it could create problems for economic management particularly monetary policy management. This means that high inflation can be induced by fiscal expansion and may hinder the conduct of monetary policy.One issue in this aspect is the financing of fiscal deficits. If the option of external borrowing is used, it can result in high inflation, exchange rate instability, high interest rate, etc which means a reversal of any gain from the conduct of contractionary monetary policy. Under extreme fiscal dominance, monetary policy becomes fully subsumed. Also, the poor implementation of budget can render monetary policy ineffective.

Current situation in Nigeria: The domestic economy is presently characterized by rising unemployment especially youth unemployment, declining growth, poverty, high interest rate and declining inflation. There have been accusations and counter accusations between the CBN and the Ministry of Finance/the Executive as to who is responsible for these socio-economic problems. For the CBN, the problem is the poor implementation of the capital budget for 2012 and the slow implementation of the structural reforms. They believe that monetary policies would have yielded more results if there is a corresponding performance from the fiscal side by way of implementation of the budget. There has been clamour for reduction of the interest rate to induce growth of the real sector. The Minister of Finance believes that the 20 percent interest rate by commercial banks presently is too high, and advocates a rate of about 12 percent. In reacting to this, Sanusi asserts that

reduction of rates depends on what happens in the fiscal space i.e. whether government can control spending. Though the Ministry of Finance under Okonjo-Iweala has been engaged in calls for fiscal prudence and blocking of leakages (eliminating ghost workers, subsidy saga, due process, etc), the CBN believes that the prudence is not prudent enough, (Akande, 2013). This clearly shows lack of coordination/complementarily between the two policy making organs.In its MPC's communiqué (July, 2012), the CBN noted their dilemma in taking a decision as to the direction of the economy especially in fixing the MPR which gives direction to the banks as to their interest rates. They enumerated three choices namely: lowering the MPR in the face of sustained slowing domestic output growth and concerns about global growth process. This they discarded because they believe it will weaken the exchange rate and adversely affect the external reserves. The second option was to leave the MPR unchanged due to the upward trending inflation. They however recognized that the logical response should be an increase in the MPR due to the rising inflation, and the sustained high liquidity in the banking sector which was taking a toll on the exchange rate. The implication of this will be a high lending rate which will have a negative repercussion on the small businesses; and lead to a higher non-performing loans in the books of the banks. These MPC is aware. Has the high liquidity led to increased private sector lending? The answer in No. Rather than being involved in financial intermediation and lending to the real sector the banks invest in high yielding government securities. Based on the need to curtail the rising inflation and rescue the naira, the CBN through the MPC decided to retain the MPR at 12.00 percent and increase the CRR from 8.00 percent to 12.00 percent. The latter is meant to reduce the liquidity in the banking sector.There are reactions to other policies of the CBN. They are seen as the cause, rather than the solution to the problem of the country. For instance, the acquisition of some banks due to the CBN consolidation exercise is blamed for part of the rising unemployment. The cashless policy is seen as being unworkable due to the infrastructural deficit. The moribund #5000 note project was seen as counteracting the cashless policy. The cashless policy is seen as being incapable of reducing inflation without addressing the issue of domestic output which is counteracted by the high interest rate. Furthermore, the policy may lead to further unemployment as the use of electronics in banking sector will mean reduction in the workforce. While the CBN is blaming the, none or poor implementation of the budget and lack of fiscal discipline as the bane of the poor macroeconomic performance of the economy, the Ministry of Finance says that it has achieved 71 percent capital project fund utilization for 2013 as at the 3rd quarter. According to CBN, if the capital budget has been implemented, there would have been improved infrastructure like roads, water, electricity, transportation, etc. which would have led to increased output. This, in their opinion would sustain the reduced inflationary trend. As it stands, they (CBN) believe that they have achieved single digit inflation, and the onus lies with the fiscal authorities to maintain it.It then follows from here that there should be a coordination or harmonization between the monetary and fiscal authorities in order to achieve economic growth and development. If the single digit inflation is not accompanied by increased output, the efforts of the CBN would have been wasted. Thus, the infrastructural deficits (transportation-road, water and rail, power, etc.) should be aggressively addressed. This will reduce the cost of doing business in Nigeria as compared to neighbouring countries like Ghana, thus making our products favourably competitive.This lies not in just reduction of interest rate but in the effective implementation of capital projects. There was conflicting figures as to the level of implementation of the 2012 budget as at July 2012. The Minister of

Finance gave the figure as 56 percent. According to her, #404b was released as at that date with #342b having cash backing. The Presidency, however, countered this by saying that #184.48b had cash backing of the released amount. It said further that only 12.16 percent of the 1.51 trillion from capital budget was released. Furthermore, Senate gave 21.5 percent, while the House of Representatives gave a 35 percent implementation rate, and the Ministry of Defence gave 95 percent implementation rate. The two policy organs should work in synergy, complementing one another, and not as competitors, moving in different directions. *(where do all these divergent and inconsistent picture of implementation rate leave us? what is the implication of this for the citizenry? what are the factors that militate against budget implementation in nigeria?)*

Conclusion

The various macroeconomic indices in Nigeria are poor. While the CBN, the organ in charge of monetary policy are pursuing monetary tightening to curb the rising inflation, there are doubts about the level of budget implementation in Nigeria. The CBN lays blame of poor economic performance, not on the ineffectiveness of the monetary policies as it has achieved single digit inflation, but on the activities of the fiscal authorities. For them, if the capital budget is effectively implemented, it will lead to increasing economic growth, employment, sustain the single digit inflation rate and reduction in poverty. There seem to be non-cooperation and coordination among the monetary and fiscal policy agencies in Nigeria. Until we achieve this cooperation and coordination amongst these agencies of government, we may continue in the bulk passing game while the economy lies in comatose.

References

[1] Akande, J. (2013), Sanusi, Monetary Policy and Economic Development in Nigeria. Sahara Reporters, June 13th.

[2] Anyanwu, J. C. (1997), The Structure of the Nigerian Economy, 1960-1997, Joanle Educational Publishers Ltd., Nigeria.

[3] (Central Bank of Nigeria Communiqué No. 81 of the Monetary Policy Committee Meeting of Monday and Tuesday, January 30 and 31, 2012)

[4] Ekpo, A. H. And U. Afangideh (2011), Fiscal Dominance and Economic Management in the ECOWAS Sub-Region, paper presented at the American Economic Association Annual Conference, January, 7-9, Denver, Colorado, USA.

[5] Ikhide, S. I. (1990), "On the Deregulation of Interest Rates in Nigeria – Myths and Realities", Nigeria Financial Review, vol. 3, no. 1, March.

[6] Mackinnon, R. (1973), Money and Capital in Economic Development: Washington DC, Brooklyn's Institution.

[7] Ndekwu, E. C. (1994), First Bank of Nigeria: A Century of Banking, Spectrum Books Ltd., Ibadan, Nigeria.

[8] Shaw, E. (1973), Financial Deepening in Economic Development: New York, Oxford University Press.

[9] Toure, D. (2012), Daily Sun, Sept 3, 2012, pp. 43, at the 53rd annual conference of Nigerian Economic Society).