



DETERMINING THE DEGREE OF FISCAL DOMINANCE AND ITS IMPLICATION ON THE CONDUCT OF MONETARY POLICY IN NIGERIA

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Abstract

This study determines the degree of fiscal dominance and its implication on the conduct of monetary policy in Nigeria. It adopts the Dynamic Ordinary Least Square (DOLS) estimation techniques and covers the periods of 1980 to 2020. The regression result shows an estimated coefficient of 0.77, which indicate a high degree of fiscal dominance in the country. In the same vein, the estimated coefficient was compared with the average value of the consumer price index and interest rate in the economy, and it was discovered that high degree of fiscal dominance corresponds with high consumer price index and interest rate in the economy. Flowing from the findings, it is concluded that there is high degree of fiscal dominance in Nigeria, and this has implication on the conduct of monetary policies in the country. The degree of fiscal dominance in the country is likely one of the factors responsible for high prices in the country. It was recommended that The Nigerian government should focus on widening the domestic revenue mobilization base of the country. This would include expanding the tax base, setting up appropriate mechanism to generate more revenue from fines, fees and licenses, providing a conducive environment for remittances inflow into the country. The Central bank should limit their finances of government expenditure to 10 percent of previous year's revenue as suggested by the World Bank. They should limit their borrowings to capital project, such that such project can boost aggregate supply and normalize average prices in the economy.

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**STOPIEŃ DOMINACJI FISKALNEJ I JEJ WPŁYW
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Słowa kluczowe: polityka fiskalna, polityka monetarna, dominacja fiskalna.

Abstrakt

W badaniu określono stopień dominacji fiskalnej i jej wpływ na prowadzenie polityki pieniężnej w Nigerii. Przyjęto technikę estymacji metodą dynamicznych, zwykłych, najmniejszych kwadratów (DOLS). Badaniami objęto okres od 1980 roku do 2020 roku. Współczynnik regresji przyjął wartość 0,77, co wskazuje na wysoki stopień dominacji fiskalnej w kraju. W tym samym duchu porównano oszacowany współczynnik ze średnią wartością wskaźnika cen towarów i usług konsumpcyjnych oraz stopą procentową w gospodarce i stwierdzono, że wysokiemu stopniowi dominacji fiskalnej odpowiada wysoki wskaźnik cen towarów i usług konsumpcyjnych oraz stopa procentowa w gospodarce. Na podstawie uzyskanych wyników można stwierdzić, że w Nigerii występuje wysoki stopień dominacji fiskalnej, co ma wpływ na prowadzenie polityki pieniężnej w tym kraju. Stopień dominacji fiskalnej w kraju jest prawdopodobnie jednym z czynników odpowiedzialnych za wysokie ceny. Zaleca się, aby rząd Nigerii skupił się na zwiększaniu dochodów krajowych. Obejmowałoby to rozszerzanie bazy podatkowej, stworzenie odpowiedniego mechanizmu generowania większych dochodów z grzywien, opłat i licencji, stworzenie sprzyjających warunków dla napływu przekazów pieniężnych do kraju. Bank centralny Nigerii powinien ograniczyć finansowanie wydatków rządowych do 10% dochodów z poprzedniego roku, zgodnie z sugestią Banku Światowego. Powinien ograniczyć swoje pożyczki do projektów kapitałowych, tak aby mógł osiągnąć odpowiednią podaż pieniądza i unormować średnie ceny w gospodarce.

Introduction

In an attempt to achieve macroeconomic objectives, government of nations adopts certain policy measures. Notably among them are monetary and fiscal policies. They include the manipulation of monetary instrument and government finances to move the nation in the desired direction. This desired direction embraces price stability, full employment of resources, economic growth and development, among others. In recent times, the relationship between monetary and fiscal policy has been increasingly discussed in macroeconomic literature, (especially after the financial crisis of 2008/2009 and the recent COVID pandemic of 2020 that force governments of nations to bail out the economy from deleterious effects of these phenomenon) (Fahr & Frank, 2010; Arby & Hanif, 2010; Belke

& Dreger, 2011) and possible connection between them have been established. The interdependence between them ranges from zero to one (De Resande, 2007), where zero denotes the presence of fiscal dominance and one monetary dominance.

Conventionally, fiscal authority is assumed to govern government budget, while monetary authority independently determines the nominal money supply and regulate for price movement in the economy (Barro, 1987; Sims, 1994; Creel & Le Bihan, 2006). In this scenario, the monetary authority establishes the price level while fiscal policy facilitates that bond are supported by tax revenue (Sargent & Wallace, 1981). This would guarantee the effectiveness of monetary policy such that there will be no connection between fiscal deficit and monetary growth, and subsequently price level.

However, if the fiscal authority does not adjust taxes nor expenditure to movement in the outstanding debt and the monetary authority has to back fully all the government debt, we have a case of fiscal dominance (Sanusi & Akinlo, 2016; Favero & Monacelli, 2003). Fiscal dominance is a situation where fiscal policy is active and monetary policy is inactive (Sims, 1994). That is, when fiscal authority becomes absolutely irresponsible to monetary policy, a situation where the Central Bank of Nigeria (CBN) print out more money to finance government expenses. This is likely indicated by a positive correlation of fiscal deficit with increasing money growth (Tanner & Ramos, 2002; Us, 2008). Jalil *et al.* (2013) argued that a positive long-run inflationary impact can be attributed to fiscal dominance which could have a deleterious effect on the economy. The presence of fiscal dominance makes it difficult for the implementation of monetary policy. Blanchard (2004) contends that if a high debt country decided to increase real interest rate to ameliorate inflation, the success of this act is contingent on whether or not the increase in interest rate raises the likelihood of debt default.

Although, literature have established the interdependency between fiscal and monetary policy to range from zero to one, in reality, these interdependencies do not assume the value of zero and one, as the monetary authority does not fully back all government debt and can only be subjected to a fraction of it. Also, the monetary authority cannot stay clear in absoluteness of government finances. In fact, the first Central banks were created explicitly to meet fiscal need (e.g., Riksbank in 1668, Bank of England in 1694) (see Hooley *et al.*, 2021). Bardo & Siklos (2018) assert that most of the Central banks found in the nineteenth century, were fiscally motivated, often for financing war. It was however, also found that many hyperinflation episodes are associated with Central bank financing of government debt (case are found in Hungary (1945–1946, Greece (1941–1945), Latin America in the 1980s, in Sub-Saharan Africa we had cases in Angola (1994–1997), Democratic Republic of Congo (1998), Zimbabwe (2007–2008; 2019–2020).

With the above, fiscal dominance is prevalent in every economy; it is the extent of fiscal dominance that determines the effectiveness and efficiency of monetary policy. Also, while Jalil *et al.* (2013) argued that a positive long-run inflationary

impact can be attributed to fiscal dominance, a number of empirical investigations have suggested otherwise (see Ornellas & Portugal, 2011) on Brazilian economy. This study would also ascertain the degree of fiscal dominance and its implication on average prices in Nigeria.

The Nigeria economy, alongside with rising budget deficit is rising inflation. Although, Tanner & Ramos (2002) claim this to be an evidence of fiscal dominance, empirical findings in recent times have produced somewhat mixed results. While some claim that rising prices have been reported in low fiscal dominance country (Ornellas & Portugal, 2011), some claim that fiscal dominance is associated with rising average prices in the economy (Jalil *et al.*, 2013). These mixed results could be as a result of focusing on the presence of fiscal dominance in an economy, instead of measuring the degree of fiscal dominance. A low fiscal dominance might be harmless to the economy, while countries with high degree might be in the danger of price instability.

While most literature have tried to establish the existence of fiscal dominance in a country or not, the paper seeks to investigate the degree of fiscal dominance in Nigeria and its implication on averages prices in the economy, because in reality, the monetary authority cannot stay clear in absoluteness the political demands of the government, hence, the interdependence between monetary policy and fiscal policy cannot be zero or one. It is the degree of fiscal dominance that determines the effectiveness of the monetary authority in its objectives of price stability.

This paper is divided into five (5) sections. The first section deal with the introduction to the study, the second section handles the literature review, the third section captures the data collection and methodological issues, the fourth section presents the result of the study and their interpretations, while the fifth section summarizes the findings of the studies with policy recommendations.

Literature Review

The Keynesian Theory of Fiscal Policy

Consequent to the great depression of the 1930s, Keynes (1936), in an attempt to unravel the cause of the great depression identified deficiency in aggregate demand as responsible for the great economic downturn, and therefore advocates government intervention as against the classical doctrine of free market. He suggested government could embark on deficit budget to stimulate the low level of output that characterizes the economic downturn. In other word, Keynes admonished actives fiscal policy, relative to monetary policy, claiming there are so many slacks in the economy to absorb the expansionary fiscal measure, without necessarily resulting in inflation. He claimed inflation in an economy are caused by structural factors rather than increase in money supply. Since Keynes advocated for this policy, scholars in the field have had mixed results in their

investigations. Scholar like Romer & Bernstein (2009); Elmendorf & Forman (2018) advocate for government action as countercyclical fiscal policy. In their findings, fiscal policy plays a significant role in adjusting for macroeconomic imbalances. There are however others who believed that fiscal policy must be restricted to have its main countercyclical impact only through automatic stabilizer (Taylor, 2002; Kraay & Serven, 2008; Cogan *et al.*, 2009; Taylor, 2009). Cogan *et al.* (2009) contend that the results obtained by Romer and Bernstein were affected by the assumption under the old Keynesian framework which exclude rational expectations that they adopted. They further argued that the results could be different under the recent Keynesian model that accommodates rational expectations by individual firms and some form of price rigidities. Beetsma (2008) had earlier discovered that the magnitude of fiscal policy on macroeconomic variables differs based on the how the model is constructed. A model with the assumption of closed economy produces a somewhat different result from that of an open economy and the set of fiscal policy instrument adopted matters. Kraay & Serven (2008) found fiscal responses to economic crisis to rarely succeed and could generate pervasive effect without strong institutions.

Monetary Theory

Owing to the great inflation of the 1960s, the monetary was spearheaded by Friedman (1963) who highlighted the danger in fiscal dominance and argued for monetary dominance as potent in achieving macroeconomic stability and other macroeconomic objectives. According to Friedman, “only money matters” and therefore, monetary policy is a more effective option in achieving macroeconomic objectives than fiscal policy. Supported by the quantity theory of money hypothesis, “inflation is always and everywhere a monetary phenomenon” and occur as a result of more rapid expansion in money supply than in output. Bernanke (2002) in explaining the implication of the quantity theory of money claim that a given change in the rate of money growth induces an equal change in average prices in the economy. The effectiveness of monetary policy has generated a lot of controversies, particularly after the financial crisis of 2009. Reinhart & Reinhart (2011) explained that two properties of macroeconomic models are especially germane to the deportment of monetary policy. First is that spending and pricing decisions are assumed to be based on long term assessments of real income and real rates of returns. The second is that, changes in monetary policy can change real interest rate only temporarily. Eventually, the forces of productivity and thrift determine them, not changes in nominal magnitude on the central bank balance sheet. Considering these two propositions, it suggests that the Federal Reserve’s interest rate policy, as long as it stays within the narrow range of experience, would not be expected to have a significant or long-lasting imprint on market or activities.

Taylor (2009) had earlier debunked explanations limiting the effectiveness of monetary policies due to the financial crisis of 2008. He presents that the Federal Reserve is held to have systematically run policy too loose from around 2002–2006, which encouraged the housing boom and the related financial market excesses. However, he noted that the deviation from tailored preferred policy were modest and such sensitivity of outcomes to those misses is hard to square with the proposition that the Fed can only keep the short-term real interest rate low for a limited time and that it is long term values that matter.

Empirical Literature

Empirical findings relating to the effect of fiscal dominance on the conduct of monetary policy have produced a somewhat different result. This could be because of the methodology or framework adopted, among other factors. Some of these findings are presented below. Sabate *et al.* (2005), in an attempt to find out of fiscal policy influence monetary policy in Spain, adopted the Vector autoregressive model. Sabate and his colleagues found that fiscal policy could interfere with strict monetary policy needed to control inflation and fix exchange rate as their investigation confirms the dominance of fiscal policy for the period. The budget deficit of the government of the nation exerts significantly positive effect on money supply, and spillover to price increase.

Hollmayr & Kulil (2018) on monetary – fiscal interaction and quantitative employed the dynamic stochastic general equilibrium model as a method of empirical investigation. Unlike Sabate and colleagues, the result of their investigation reveals that under fiscal dominance, and unconventional monetary policy has similar effects to conventional monetary policy on inflation because the wealth exercises downward pressure on price. Bajo-Rubio *et al.* (2009) present an inconclusive result on their investigation into deficit sustainability and inflation in the Economic and Monetary Union (EMU), adopting the fiscal theory of price as a framework. Their finds however show sustainability of fiscal policy in all EMU countries, other than Finland.

Sanusi & Akinlo (2016) investigated fiscal dominance in Nigeria for the period of 1986 to 2013. Mr Sanusi and Akinlo adopted the structural vector autoregressive model to examine the presence of fiscal dominance in Nigeria. Their analysis reveals that shocks to fiscal deficit of government does not stimulate responses from growth of monetary base and no causality was found running from fiscal deficit to growth in monetary base in the country. A somewhat different result was reported by Nachegea (2005) who conducted a similar study on Democratic republic of Congo. He however adopted a different methodology in multivariate cointegration analysis and vector error correction model (VECM). Nachegea recorded a strong and statistically significant relationship between government deficit financing and seigniorage, money supply also motivates

inflation in the country. Prior to Nachegea’s investigation, Chaudhary & Ahmad (1995) has reported a similar result on their investigation of money supply, deficit financing and inflation in Pakistan. They found that monetary policy may be handled by the monetary authority, but the fiscal decision if the government determines the overall formulation macroeconomic policies.

Van (2014) employed a high frequency data in monthly series to examine the effect of budget deficit on money supply and inflation in Vietnam between 1995 and 2012. Van found that budget deficit has no effect of money supply and inflation in Vietnam. Oladipupo & Akinbobola (2011) had conducted a similar study on Nigeria between 1959 and 2005 and found a result similar to that of Van.

Conceptual Framework

This study adopts the theoretical frame of Sabate *et al.* (2005) which claim that fiscal dominance begins with a perpetual and rising budget deficit. Budget deficit occurs when government estimated revenue is less than her proposed expenditure. Hence, the need for government to sources for finance to fill the lacuna between the estimated revenue and proposed expenditure. There two sources the government can explore. The first is the internal source that includes Central bank financing and the second is the external source that comprise of borrowings from multinational institutions. The linkages of fiscal dominance to monetary policy are presented schematically below (Fig. 1).

When government deficit is finance by creation by the Central bank, it increases the stock of money in circulation, and without corresponding increase in output, it results in rising prices, exchange rate devaluation, and low interest rate. These ultimately inhibit the ability of the Central bank to maintain stable prices in the economy.

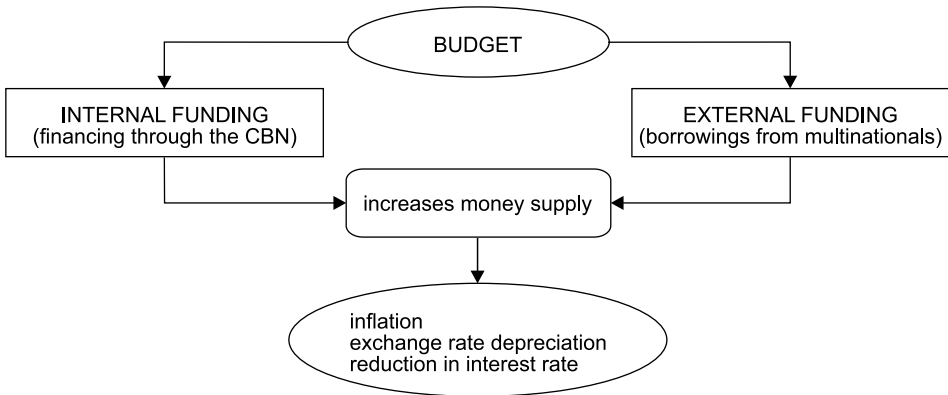


Fig. 1. Linkages of fiscal dominance to monetary policy

Source: own elaboration.

Data and Methodology

The study will adopt annual series from the Central Bank of Nigeria statistical bulletin (2019). The scope of the study will cover the periods of 1981 to 2020. The data to be adopted include money supply, budget deficit and prime lending rate (interest rate). Money supply here is the broad money supply (M2) which is the local currency in circulation, plus demand deposit, savings and fixed deposit. This measures the total volume of money in circulation as decided by the monetary authority. Budget deficit is the magnitude by which government proposed expenditure exceeds her total revenue. The essence of this study is to see the magnitude at which budget deficit derives money supply in the economy. The interest rate represents the lending rate. It measures the cost of capital. It is employed as a control variable as it constitutes one of the monetary policy instruments of the monetary authority. Exchange rate and consumer price index are also employed as prices in the model on which we measure the effect of fiscal dominance.

The study will adopt a dynamic Ordinary Least Square (DOLS) estimation technique because of its potential to accommodate both stationary and non-stationary series. Although the Ordinary least square is adjudged to be the best linear estimator as it produces minimum variance and an estimate closer to population mean, all assumption guiding this model must be satisfied for it to produce the best linear estimate. One of the important requirements is that the series in the model must be a level series, but in reality, most of these series exhibit non stationarity, and consequently render OLS inefficient. The DOLS adjusts for the weaknesses of OLS, as it improve the OLS by coping with small samples and the dynamic source of bias (Stock & Watson, 1993). It also has the advantage of providing a robust correction to the possible presence of endogeneity in the explanatory variables, as well as serial correlation in the error term of the OLS estimator (Bajo-Rubio *et al.*, 2009). This method however requires that the series be cointegrated. Hence, before the application of the method, pre-estimation tests like stationarity and cointegration test will be conducted.

The model for the study is to be specified as follow:

1. Objective one

$$\text{money supply} = f(\text{budget deficit, interest rate}) \quad (1)$$

This is reparametrized as follows:

$$\text{money supply} = a_0 + a_1 \text{ budget deficit}_t + a_2 \text{ interest rate}_t + \varepsilon_t \quad (2)$$

where:

a_0, a_1, a_2 – are the estimation parameters, but it is the magnitude of a_1 that measures the degree of fiscal dominance in the economy. This value is expected to range between 0 and 1. Any value close to 1 would signal high level of fiscal dominance in the economy.

2. Objective two

To achieve how degree of fiscal dominance affect average price level, the estimated parameter of α_1 will be measured against the average prices as inflation, and interest rate. This is because there no ready time series data to capture the degree of fiscal dominance, as the estimated α_1 captures the average level of fiscal dominance in the economy over the periods considered. Therefore, the estimated mean of inflation, and interest rate over the period will be compared with the estimated level of fiscal dominance. A single digit inflation and interest figure will denote moderate inflation and interest rate level. If the estimated parameter α_1 is less than 0.5 and we have a single digit inflation and interest rate, then low level of fiscal dominance corresponds with low prices. If on the other hand, the estimated α_1 is greater than 0.5 and correspond with single digit average prices, then high level of fiscal dominance does not affect average prices in the economy (Sanusi & Akinlo, 2016).

Results and Interpretations

The descriptive characteristics of the series in the model are presented in Table 1. It includes such descriptive statistics as: mean, median, standard deviation, skewness coefficient, kurtosis, median and others.

Table 1

Descriptive statistics of the series in the model

Statistics	MS2	PLR	BD1	CPI
Mean	6,230.7	22.1	630.8	19.1
Median	1,036.1	21.6	103.8	12.6
Maximum	29,137.8	36.1	4,913.8	72.8
Minimum	16.2	10	1	5.4
Std. Dev.	8,935.7	6.2	1,158.3	17.1
Skewness	1.3	-0.1	2.3	1.8
Kurtosis	3.2	2.7	7.8	5
Jarque-Bera	10.7	0.2	72.6	27.2
Probability	0	0.9	0	0

Source: computed from eviews 10.

Over the periods of 39 years, average money supply stood at N6,230 billion, which represent about 38,451 percent increase from 1981. Money supply in the economy has maintained a significantly continuous increase over the year. This would have implications on macroeconomic condition of the economy, like GDP, average prices among others. The maximum lending rate (MLR), which represents

the cost of capital in the economy, has an average figure of 22.1 percent. Compare to 1981 figure, the rate has increases by about 121 percent. The implication of increase in the cost of capital is that it increases the opportunity cost of holding capital in the economy. Real exchange rate recorded an average of N94.3 per dollar within the periods. From 1981, it has increased by about 15,359 percent, meaning that the value of naira to naira to dollar has reduced by about 15,359 percent. The average size of budget deficit with the period stood at N630.8 billion, which represent an average increase of 16,074 percent increase from the year 1981. This means that from 1981, government budget deficit has increase 160.7 times. The consumer price index recorded an average of 19.1 percent under the periods of study. This would mean that on the average, consumer prices increase by 19.1 percent. This implicates that real income of consumer equally reduces by 19.1 percent. Table 2 shows the stationarity properties of the series in the model.

Table 2

Unit root test

	ADF		PP		$I(d)$
	levels	first difference	levels	first difference	
LBD	-5.038***	-10.148***	-5.080***	-15.272***	$I(0)$
LM2	-0.898	-3.852**	-0.956	-3.783**	$I(1)$
LEXCH	-1.278	-5.608***	-1.267	-5.819***	$I(1)$

Source: computed from eviews 10.

This test allows us to ascertain the predictability or relative stability of the series in the model over a long time. The test reveals that the series are stationary in mixed order $I(0)$ and $I(1)$. $I(0)$ variable are stationary series whose movement are relatively predictable overtime, while $I(1)$ variables are non-stationary variables whose values are subject to periodic and relatively unpredictable movement. Budget deficit (LBD) appears to be stationary at levels, while money supply (LM2) and exchange rate (LEXCH) are stationary only after first differencing. Because the series are stationary at mixed level of integration, there is a need to ascertain whether or not long-run relationship exists among the variables. This relationship is established by conducting a cointegration test as presented in Table 3 below.

The essence of the test is to establish whether or not long-run relationship exist among the variables in the model. For cointegration to be established, the trace statistics and max-eigen statistics are expected to exceed the critical value at 5 percent significant level. The table above shows cointegration exists among the series in the model with both Trace and max-eigen statistics greater than the critical values at 5 percent significant level. The presence of cointegration in the model fulfills the condition for the use of Dynamic Ordinary Least Square estimator as presented in Table 4 below.

Table 3

Cointegration test using both trace statistics and Maximum Eigenvalue

Unrestricted cointegration rank test (trace)				
Hypothesized	–	trace	0.05	–
No. of CE(s)	eigenvalue	statistic	critical value	prob.**
None*	0.324	33.286	29.797	0.019
At most 1*	0.313	19.192	15.495	0.013
At most 2*	0.146	5.690	3.841	0.017
Unrestricted cointegration rank test (maximum eigenvalue)				
Hypothesized		max-eigen	0.05	
No. of CE(s)	eigenvalue	statistic	critical value	prob.**
None	0.324	14.094	21.132	0.357
At most 1	0.313	13.502	14.265	0.066
At most 2*	0.146	5.690	3.841	0.017

Source: computed from eviews 10.

Table 4

The regression result measuring the degree of fiscal dominance in Nigeria

Dependent variable: LOG(MS2)				
Method: dynamic least squares (DOLS)				
Variable	coefficient	std. error	t-statistic	prob.
LOG(BD)	0.772	0.304	2.537	0.017
EXCH	0.012	0.008	1.573	0.127
C	2.545	0.762	3.339	0.003
R-squared	0.931			
Adjusted R-squared	0.911			

Source: computed from eviews 10.

The relationship between government deficit financing and money is established to be positive and significant. From the result, a percentage increase in government budget deficit likely increases by about 0.77 percent. This would mean that for every N100 increase in budget deficit, money supply increases by about N77 in the Nigerian economy. From literature, the relationship between fiscal and monetary policy ranges between 0 and 1 (De Resande, 2007), with values close to 0 interpreting low degree of fiscal dominance, while values approaching 1 hint at high degree of fiscal dominance. With a coefficient of 0.77, approximately, close to unity, it implies that in the coordination of fiscal and monetary policy in Nigeria, the fiscal policy is more active. This is an indication of high degree of fiscal dominance in the country. The adjusted *R*-squares depicts about 91 percent of changes in money supply are explained by budget deficit and exchange rate.

Examining the Trend of Inflation and Interest Rate in Respect to Degree of Fiscal Dominance in Nigeria

Having estimated the degree of fiscal dominance in Nigeria, it is imperative to analysis its relationship with average prices in inflation and interest rate owing to conflicting arguments in literature. While Kydland & Prescct (1977), Barro & Gordan (1983) identified fiscal dominance to be highly correlated with high prices, empirical works in Bade & Parkin (1982), Alesina & Summers (1993) suggested the contrary, claiming fiscal dominance correlates with lower levels of inflation in their findings. Since 1980, the consumer price index has been relatively unstable and main an average of 19.1 percent (Fig. 2).

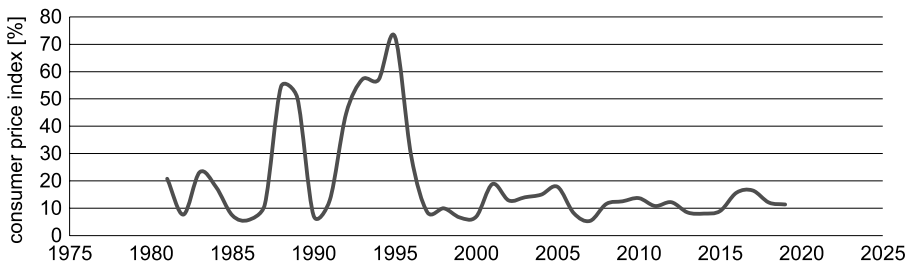


Fig. 2. Trends of consumer price index in Nigeria

Source: own elaboration.

Only in 1982, 1985, 1990, 1997, 1999, 2013, 2014 and 2015 did we record a single digit rate. This signals high level of inflation in the Nigerian economy. High inflation level signifies high reduction in the real income of consumer, which invariably increases the cost of living, and reduces the standard of living in the economy. Coincidentally, high inflation rate corresponds with periods of high degree of fiscal dominance in the country, with the degree of fiscal dominance of 0.77 on a scale of one, and average inflation rate of 19.1. Intuitively, high inflation rate in the country could be strongly associated with the inability of the CBN to effectively and efficiently pursue the objective of price stability as against financing government activities as shown in the estimated degree of 0.77 (Fig. 3).

Looking at the interest rate in Figure 3, it had an upward trend from 1980 to 1991 and thereafter maintains an average downward trend till date. Increase in interest rate signifies an increase in the cost of holding capital, and invariably discourages investment. On the average, Nigeria records an average interest rate of 22.1 percent within the periods of analysis. This rate is on the high side and also corresponds with periods of high degree of fiscal dominance in the country. This could mean that in an attempt to curb the rising average consumer price index occasioned by increase in money supply, the monetary authority increases the interest rate to contract the volume of money in the economy.

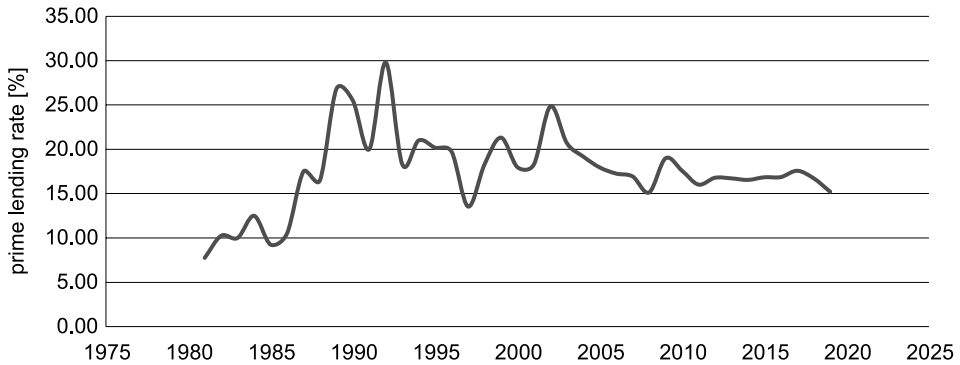


Fig. 3. Trends of prime lending rate in Nigeria

Source: own elaboration.

Summary, Conclusion and Recommendation

The study focuses on determining fiscal dominance and its implication on the conduct of monetary policy in Nigeria. The specific objectives are to determine the degree of fiscal dominance in the country and its implication on average prices. The scope of the study ranges from 1981 to 2020. The dynamic OLS estimation method was adopted after establishing cointegration among the series in the model. The regression result shows an estimated coefficient of 0.77, which indicates a high degree of fiscal dominance in the country. In the same vein, the estimated coefficient was compared with the average value of the consumer price index and interest rate in the economy, and it was discovered that a high degree of fiscal dominance corresponds with a high consumer price index and interest rate in the economy.

Flowing from the findings, it is concluded that there is a high degree of fiscal dominance in Nigeria and this has an implication on the conduct of monetary policies in the country. The degree of fiscal dominance in the country is likely one of the factors responsible for high prices in Nigeria. From the conclusion from the study, the followings are recommended;

1. The Nigerian government should focus on widening the domestic revenue mobilization base of the country. This would include expanding the tax base, setting up appropriate mechanisms to generate more revenue from fines, fees and licenses, providing a conducive environment for remittances inflow into the country.
2. The Central bank should limit their finances of government expenditure to 10 percent of previous year's revenue as suggested by the World Bank.
3. They should limit their borrowings to capital projects, such that such projects can boost aggregate supply and normalize average prices in the economy.

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