

RELATIVE EFFECTIVENESS OF MONETARY AND FISCAL POLICIES ON ECONOMIC GROWTH IN NIGERIA

Dr. Osodiuru, Peter E.

Department of General Studies, Federal Polytechnic Ngodo – Isuochi, Abia State, Nigeria

Email: osodiurupeter@gmail.com

D.O.I: 10.5281/zenodo.18833906

Received: 02.12.2025 | Accepted: 30.12.2025 | Published: 27.01.2026

ABSTRACT

RESEARCH ARTICLE

This study looks at how well fiscal and monetary policies worked together to boost Nigeria's economy from 1990 to 2023. It focuses on fiscal policy variables such as taxes and expenditure by the government as well as those of monetary policy like interest rate changes and money supply. The study attempts to determine the best policy for fostering stability and sustained growth by contrasting their effectiveness in various economic circumstances. To investigate the short- and long-term correlations between these variables, the study uses Autoregressive Distributed Lag (ARDL) / Error Correction Model (ECM), because it can handle time series data with variables integrated at multiple orders, the ARDL technique is especially well-suited for this kind of analysis. The primary variables under investigation are the dependent variable (GDP growth) and the independent variables (monetary and fiscal policy indicators). The fiscal policy has a more significant and sustained influence on Nigeria's long-term economic growth. Government taxes and expenditure are key drivers of growth throughout the studied period, especially during recession periods. On the other hand, monetary policy has little impact on long-term growth but has been more successful in handling pressing short-term problems of inflation and currency stabilization. These findings imply that Nigeria's economic strategy should place a higher priority on fiscal policy, with an emphasis on enacting tax changes and improving the effectiveness of government expenditure. In general, this research offers significant perspectives for decision-makers who aim to encourage steady economic expansion and stability in Nigeria.

KEYWORDS: GDP, monetary policy, fiscal policy, indicators, taxes, ARDL

INTRODUCTION

Generating economic growth has been identified as one of key imperatives for poverty reduction and development, (Chiamogu, Nweke & Mba, 2012). However, a reasonable number of economic and non-economic variables capable of influencing such economic growth have been suggested by existing growth literature, (Kamyab, 2014). The role of macroeconomic policy in bringing about the needed sustainable and credible economic stability, thereby ushering in the environment for rapid economic growth cannot be overemphasized. To achieve this task, monetary and fiscal policies as its fundamental components are essential. It can be said that the necessary condition for success in the

functioning of an economy is more or less, the presence of well coordinated activities of monetary and fiscal policies, the absence of which eventually results to poor overall economic outcomes. These policies, though conducted by separate authorities, are mutually dependent. It is, therefore, highly important to actualize a sustainable and consistent policy-mix framework, so as to harmonize monetary and fiscal policies and minimize inconsistencies, (Adewale, 2018).

Monetary policy can be regarded as a conscious effort by monetary authorities to exercise control over the money supply and the credit conditions in a bid to achieve desired economic objectives. The objectives of monetary policy, for most economies include price stability, maintenance of balance of payments equilibrium, employment and output growth, and promotion of sustainable development. These monetary policy measures are essential for the achievement of internal and external balance, and the promotion of long-run economic growth. For instance, an expansionary monetary policy targeted at stimulating economic growth is capable of lowering the rate of interest and generating higher inflation which the level of growth may be unable to avert. The potency of monetary policy in actualizing its target objectives, is therefore, dependent upon the operating economic milieu, adopted institutional framework and choice and mix of instruments.

Fiscal policy refers to the use of instruments such as taxation, budget and quotas to influence government revenue and expenditure in order to achieve desired macroeconomic objectives. For instance, tax revenue is most likely to increase when an economy is expanding, 'ceteris paribus' even without change in fiscal policy. The upward movement in tax revenue could further push up government expenditure thereby resulting into more expansion, so long as such spending is directed to the provision of basic infrastructures that are complementary to private investment. Therefore, government can use fiscal policy to stimulate the economy through manipulation of taxes and government spending. Fiscal policy, therefore, creates avenue for the dynamic use of the government budget for actualizing the objectives of economic growth.

Monetary and fiscal policy play significant role in attaining macroeconomic objectives in both developed and developing economies. Appropriate mix of monetary and fiscal policies serves as impetus for the maintenance of price, financial sector and external balance stability which eventually leads to rapid and sustainable growth of the economy.

Nadeem and Farooq (2003) disclosed that the desire of monetary and fiscal policies is to assure that the economy arrive at stable development of its financial system with no high inflation. There is a close relationship between monetary and fiscal policies irrespective of the fact that they are different in circumstances of range and time lags in manipulating financial situations. Monetary and fiscal policies are the two major macroeconomic tools commonly used in influencing the economy in line with desired objectives. In the view of Laurens & Piedra (1998), monetary policy, in most countries, has been instrumental in fiscal policy implementation. This according to them is because monetary authorities always have the responsibility of financing budget deficits. According to Heyne (2002), the motivation and goals of monetary and fiscal authorities may not be the same but the impact of their policy choices on aggregate demand in the economy is crucial. Monetary and fiscal policy, in the words of Adefeso and Mobolaji (2010), are inseparable in macroeconomic management. Government, therefore needs to strike the required balance so that the desired outcome of one is not neutralised by the influence of the other. The impact of monetary and fiscal policy on the economy tends to differ as government implements them simultaneously. A strong moderating influence can be exerted on the exogenous factors that have militated against the

rapid growth of the Nigerian economy if sound monetary, fiscal policies and good governance are vigorously pursued. The recent global financial crisis has evidently led further credence to the argument on the relative potency of monetary and fiscal policies among economists. The matter of appropriate mix of the two policy options is still an issue especially in developing economies. Ogbole (2010) stated that the issue of appropriate mix of policy measures is yet to be addressed in Nigeria. Nigeria, like many other developing countries, is more or less confronted with serious developmental challenges at present. Several challenges have plagued she has not been able to harness her economic potentials in spite of an array of macroeconomic policies that often change from time to time. The debate on the relative effectiveness of monetary and fiscal policy in promoting economic growth and development remains more or less inconclusive, given the conflicting results of recent studies, (Adeoye, 2006). Moreso, most studies in this area devoted more attention in favour of developed countries where as developing economies were mainly included for the generation of more degrees of freedom, (Aregbeyen, 2007). It is against this backdrop, that the researcher dimmed it fit to fill the research gap by conducting this research on relative Effectiveness of monetary and fiscal policies on economic growth in Nigeria.

Theoretical Framework

The theoretical framework adopted for the present study centers on the Keynesians and the Monetarists. According to the Keynesians, a change in money supply may change the level of output through change in interest rates. They reasoned that classical mechanism may be unable to guarantee full employment equilibrium for some reasons. First, wages and prices may not be flexible; again, savings may be determined by income instead of interest rate, if the speculative demand for money has infinite elasticity with regards to changes in interest rates. In the 1930s, Keynes in his "Theory of Public Finance" opined that government revenue and spending should be used in reducing cyclical variations in the economy. The monetarists argue that as long as real variables can be affected by money in the short run, the classical theory rather than the Keynesian would be valid, in which case only nominal magnitudes are affected in the long run. The leader of the monetarist school, Milton Friedman came up with a 'modern' quantity theory with its roots in the 'ancient' version but broader than the 'ancient'. The 'modern' quantity theory can be simply stated thus: given that the demand for money is stable; the price level will be changed by a change in money supply, which in the short run also alters the real value of national income and by extension economic activity. The effects of changes in money supply on total income and expenditure can be predicted as long as there is stability in the demand for money. The argument of the monetarists is that if the money supply increases, it will lead to an increase in output and employment in the short run as a result of an increase in expenditure, that is if there is less than full-employment in the economy. After a period of time, other real factors will cause the economy to return to the position of less than full employment. According to the monetarist school of thought, real variables cannot be affected, in the long run, by changes in money supply. At or beyond the point of near-full-employment, increase in money supply will cause prices to rise. Income increases with an increase in money supply and expenditure, before full employment. The ratio of income to money supply will then determine the increase or otherwise in income since output can hardly be increased at that point. The demand for money will then rise to be equal, once again to the supply of money.

Review of Theoretical Literature

Adewale (2018) opined that both government expenditure and money supply have been accorded prominent positions in the macroeconomic management of developing economies but that their relative effectiveness has constituted a debate between the Keynesian and monetarist schools of thought. According to the monetarist school, a greater impact is exerted on economic activities by money supply while the Keynesian school considers government expenditure as having greater influence. Given the prominence accorded both government expenditure and money supply with respect to their impact on economic activities, it is not a surprise then that they are intertwined. Monetary and fiscal policies can be said to be linked such that development in one more or less affects that in the other. Fiscal policy is, without doubt quite central to the wellbeing of any of any economy since citizens' disposable income and by extension the overall business climate is seriously affected by the power of government to tax and spend. In line with the foregoing, the importance of the relationship between government expenditure and private sector performance cannot be overemphasized. Public spending is capable of providing the impetus for the growth of private sector but it can be counter-productive if it brings about budget deficit and results to financial resource competition with the banking sector in the government's bid to finance the deficit. In such a scenario, especially if the public sector overshadows its private counterpart, any anticipated short term benefits of an expansionary fiscal measure is outweighed or offset.

Monetary Policy and its fiscal counterpart constitute the two major macroeconomic policies employed by most economies to achieve economic growth and sustainable development. Achieving economic growth is one of the major objectives of monetary and fiscal policies in most economies. This is of serious importance without excluding other macroeconomic objectives such as employment generation, price stability, sustainable economic development, equity (redistribution of income), favourable Balance of Payment, stability in exchange rate and increased investment.

Fiscal policy can be associated with the use of government revenue and expenditure to control the level of economic activities. It is principally implemented through the channel of government budget. Therefore, the budget is much more than just a plan for administering the public sector. Through the budget a country's economic life is both reflected and shaped. Omitogun and Ayinla(2007) have recognized the use of public budget in the management of an economy as its most important aspect. Governments use fiscal policy to influence aggregate demand level in the economy in a bid to realize macroeconomic objectives, (Heyne, 2002). Fiscal policy borders on governments' execution of deliberate initiatives for the purpose of moving macroeconomic variables towards a desired direction. The main target of fiscal policy, therefore, is to stabilize the economy. An increase in public expenditure or a decrease in taxation is capable of pulling an economy out of a recession; while a reduction in expenditure or increase in taxes can slow down a boom; all things being equal (Dornbusch and Fischer, 1990).

Monetary Policy can be defined as the deliberate use of monetary instruments by monetary authorities so as to achieve macroeconomic stability. It is a principal tool for the execution of monetary and price stability mandate. According to Dwivedi (2005), monetary policy is a programme of action undertaken by monetary authorities, to control and regulate the supply of money with the public and the flow of credit in order to achieve predetermined macroeconomic goals. It can also be seen as the process by which the government, through the Central Bank or a country's monetary authority, controls the supply, availability and cost of money, so as to attain a set of objectives targeted at the growth and stability of the

economy. It uses a variety of instruments to control either the supply of money, the rates of interest or both; in order to influence outcomes such as economic growth, exchange rates, inflation and unemployment (Orphanides, 2008).

According to Ogbole (2010) monetary policy can either be expansionary or contractionary. An expansionary policy increases the money supply, or decreases the rate of interest. A contractionary policy reduces money supply or raises the rate of interest. Monetary policy can also be described as accommodative, if it intends to create economic growth; neutral, if it intends neither to create growth nor to combat inflation; or tight, if the intention is to reduce inflation. Fadare (2010) explained that it is only when the money and financial markets of economies are sufficiently developed that monetary policies can be effective. In such a situation, a deliberate change in a monetary variable influences the movement of other variables, more or less, in desired directions. Adeoye (2006) disclosed that monetary policy comprises a government's conscious efforts to manage the money in the economy so as to achieve specified macroeconomic goals. He further disclosed that monetary policy outcomes have seriously improved of recent- the levels of inflation have largely been moderate coupled with high domestic output growth. According to him, there is need to sustain the efforts by employing appropriate collaboration with authorities of the fiscal sector and at the same time developing confidence in the necessary financial and banking sector infrastructure such as the inter-bank market.

As observed by Akpakpan (1999), economic growth refers to the process of improvement in the various aspects of the economy and the society it supports. The improvement is usually shown in the desirable changes such as decrease in unemployment level, degree of personal and regional inequalities, level of absolute poverty and increase in the real output of goods and services. Other areas of desirable changes include improvement in literacy, housing, health services and in the production capacity. The primary reason for desiring economic growth is to raise the general standard of living within the economy. Robbins (2006) uncovered that the level of income disparity, unemployment, poverty and inflation, is astronomically high such that the standard of living of an average person remains completely low in many countries across the globe. The situation captured above is more pronounced in developing and less developed economies of the world. Governments and policy makers in such economies search for policy measures and strategies to "push" their ailing economies out of the low socioeconomic state.

Many countries are in search of ways and means to advance technologically, industrially and economically so as to reduce to the barest minimum, poverty and its associated indices. One of the basic routes of achieving such feat is the deployment of macroeconomic policies such as fiscal and monetary policies (Ekpo, 2004). Economic growth has long been considered an important goal of economic policy with a substantial body of research dedicated to explaining how this goal can be achieved. It represents the expansion of a country's potential gross domestic product. For example, if the private return on investment is exceeded by the social rate of return, then the growth rate and utility levels can be raised by 'encouraging' tax policies. Insight into reasons for different rates of state growth over time has been provided by economic growth. This influences government in her tax rates choices and levels of expenditure at which growth rates will be influenced (Fadare, 2010).

Literature abounds on the relative potency of monetary and fiscal policy in both developed and developing economies. There are, however, conflicting opinions as to which of the policies impact more on economic activities (Ajisafe and Folorunsho, 2002). It is thought that fiscal policy stifles economic growth in that it distorts the impact of tax and government

expenditure. In the light of the above, therefore, the question becomes, what has been the effect of fiscal policy on economic growth in Nigeria. Adefeso and Mobolaji (2010) saw fiscal policy as consisting of the manipulation of government finances by increasing or reducing taxes or levels of expenditure to promote economic growth and stability. This role of the public sector in economic management is carried out through the formulation and implementation of economic policy, particularly fiscal. Its major objectives include, stability in prices, economic growth, balance of payments equilibrium, realization of full employment, resource mobilization and investment. Monetary policy has to do with the discretionary control of the supply of money by the monetary authorities (Central Bank with Federal Government) so as to realize desired or stated economic goals. Ekpo (2004) stated that governments tend to control the money supply owing to the belief that the rate of inflation is affected by their rate of growth. Hence monetary policy consists of those government actions tailored towards influencing the monetary sector's behavior.

In Nigeria, the outcome of government role in economic activities and the achievements in economic performance have been mixed. Ogbole (2010) revealed that the economy experienced growth in real output in some years and declines in others. But the overall picture is low scoring for the country's development efforts. Aregbeyen (2007) stated that fiscal and monetary policies' goals in Nigeria are diverse, outlining increase in the growth rate of gross domestic product, reduction in unemployment and inflation rates, balance of payments improvement, financial savings and external reserves accumulation, as well as Naira exchange rate stability.

Related Empirical Studies

This section concentrates on the empirical studies related to the present study and they are discussed as follows:

Tchokote and Philemon (2016) employed correlation analyses, unit root tests, ordinary least squares (OLS) as well as causality tests in analyzing various objectives and testing hypotheses with respect to 'The Impact of Monetary and Fiscal Policies on Economic Growth in Nigeria'.

They discovered that the coefficient of money supply as revealed in their multiple regression was more significant than that of government expenditure and therefore concluded that monetary policy has made more impact to improve the economy of Nigeria than fiscal policy though contrary to their expectation.

Havi and Enu (2014) conducted a study examining the relative importance of monetary and fiscal policy on growth in Ghana. Using OLS estimation techniques for the period 1980-2012, their study showed that although the impact of monetary policy is more significant, both policies have positive impact on growth in the case of Ghana. Another study by Jawaid and Naeemullah (2010) examined the relative effect of the two sets of macroeconomic policy tools on growth in Pakistan during the period 1981-2009. Their findings showed the existence of a positive long-run relationship between both policies and growth. It was also shown that monetary policy is more effective than fiscal policy in promoting growth. Mahmood and Sial (2011) used time series data over the period 1973-2008 and found that monetary and fiscal policies both have significant impact on growth in Pakistan.

Ekpo (1994) examined the contributions of public expenditure to economic growth in Nigeria over the period 1960 to 1992. The study's findings supported fiscal policy-led growth through crowd-in private investment resulting from government spending on infrastructure. Oyinlola (1993), carried out a study on the impact of budgetary expenditure on the defence sector on economic development of Nigeria and found that defense expenditure exerts significant positive impact on economic growth. Ajisafe and Folorunso (2002) studied the relative impact of monetary and fiscal policy in Nigeria during the period 1970-1998, using cointegration and error correction estimation techniques, the study found that monetary policy rather than fiscal policy exerts a great impact on economic activity. Adefeso and Mobolaji (2010) on the same country but for a time period, 1970-2007, applied the same econometric procedure and reached the same results as those found by Ajisafe and Folorunso (2002), suggesting that the potency of monetary policy is stronger than that of fiscal policy.

References

- Adefeso, H. A. & Mobolaji, H. I. (2010). The fiscal-monetary policy and economic growth in Nigeria: Further empirical evidence. *Pakistan Journal of Social Sciences*, 7(2), 137-142.
- Adeoye, T. (2006). Fiscal policy and growth of the Nigerian economy. *NISER Monograph Series*.
- Adewale, E.A (2018). An empirical analysis of effectiveness of monetary and fiscal policy instruments in stabilizing economy: Evidence from Nigeria. *Social Sciences*, 7 (3), 133-140.
- Ajisafe, R. A., & Folorunso, B. A. (2002). The relative effectiveness of fiscal and monetary policy in macroeconomic management in Nigeria. *African Economic and Business Review*, 3(1).
- Akpakpan, E. B. (1999). The economy towards a new type of economics. Port Harcourt: Belpot Publishers.
- Aregbeyen, O. (2007). Public expenditure and economic growth in Africa. *African Journal of Economic Policy*, 14(1): 1-25.
- Chiamogu, P. A, Nweke, E & Mba, C.C (2012). Making poverty a history in Africa: The role of the G8. *International Journal of Sustainable Development & World Policy*, 1(1), 29-59.
- Dornbusch, R, & Fischer, S (1990). *Macroeconomics* (5th ed.) New York: McGraw-Hill Publishing Company.
- Ekpo, A. (1994). Public expenditure and economic growth in Nigeria 1960 to 1992: Final Report. Nairobi: AERC.
- Ekpo, A. H. (2004). "The economics of structural adjustment and the adjustment of economics". 9th Inaugural lecture delivered in the University of Uyo on January, 28.

- Fadare, S.O. (2010). Recent banking sector reforms and economic growth in Nigeria. *Middle Eastern Finance and Economics*. 8: 1450-2889.
- Gujarati, D.N & Porter, D.C (2009). Basic econometrics. New York: McGraw-Hill Publishing Company.
- Havi, E. D. K., & Enu, P. (2014). The effect of fiscal policy and monetary policy on Ghana's economic growth: Which policy is more potent? *International Journal of Empirical Finance*, 3(2).
- Heyne, T. S. et al (2002). Monetary policy and growth prospects in developing countries. *Economic Review*, 6(4).
- Jawaid, S. T., Arif, I. & Naemullah, S. M. (2010). Comparative analysis of monetary and fiscal policy: A case study of Pakistan. *NICE Research Journal*, 3, 58-67.
- Kamyab, S.H (2014). The entrepreneurship, knowledge spillover and economic growth. *International Journal of Sustainable Development & World Policy*, 3(2), pp 31-44.
- Lambertini L. & Rovelli R. (2003). Monetary and fiscal policy coordination and macroeconomic stabilization: A theoretical analysis", Working Papers 464, Dipartimento.
- Mahmood, T. & Sial, M. H. (2011). The relative effectiveness of monetary and fiscal policies in economic growth: A case study of Pakistan. *Asian Economic and Financial Review*, 1(4), 236-244.
- Medee, P.N & Nembee, S.G (2011). Econometric analysis of the impact of fiscal policy variables on Nigeria's economic growth (1970 - 2009). *International Journal of Economic Development Research and Investment*, 2(1).
- Microsoft Corporation (2004). Microsoft Encarta Encyclopedia
- Nadeem, M. H. & Farooq, M. A. (2003) Monetary and fiscal policy coordination. MPRA Paper number 10307, <http://mpa.ub.uni-muenchen.de/>
- Ogbole, F.O. (2010). Fiscal policy and macroeconomic performance in Nigeria. *Unpublished PhD Thesis, Department of Banking and Finance, Rivers State University of Science and Technology, Port Harcourt.*
- Olaloye, A. O. & Ikhide S. I. (1995). Economic sustainability and the role of fiscal and monetary policies in a depressed economy: The case study of Nigeria. *Sustainable Development* 3, 89–100.
- Omitogun, O & Ayinla, T.A (2007). Fiscal policy and Nigerian economic growth. *Journal of Research in National Development*. 5 (2).
- Oyinlola, O. (1993). Nigeria's national defence and economic development: An impact analysis. *Scandinavian Journal of Development Alternatives*, 12(3).

- Robbins, J. C. (2006). Standardizing economic policies for development and growth. *Economic Review*, 28(6).
- Soludo, C, (2001). 'Debt, poverty and inequality: Towards an exit strategy for Nigeria and Africa.' In *Proceedings of International Conference on Sustainable Debt Strategy*. Abuja. Nigeria.
- Tchokote, J & Philemon, I. I. (2016). The impact of monetary and fiscal policies on economic growth in Nigeria. *International Journal of Social Sciences*, 10 (4), 174-191.