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1.0 Introduction

It is incontrovertible that an effective and efficient monetary policy is essential for economic growth and development. This is borne out of the fact that pragmatic monetary management regulates liquidity to an optimal level to ensure macroeconomic stability which is imperative for growth. Monetary management is usually carried out by the central bank using various instruments at its disposal to regulate the availability and cost of money in consonance with the absorptive capacity of the economy. Generally, low and stable inflation has become the core mandate for most central banks for obvious reasons that inflation has costs which are detrimental to economic agents, particularly, as it affects rational decisions and to the economy as a whole. However, most central banks in developing and emerging economies are further entrusted with developmental functions that ultimately impair their core mandate. In these economies, several factors including shallow markets, inadequate data and fiscal dominance inhibits the ability of the central banks to effectively superintend over the monetary management process. Thus, in this group of countries, inefficient markets create distortion for financial intermediation, inadequate data obstruct monetary programming and unbridled fiscal expansion impairs monetary policy performance.

The Nigerian economy shares somewhat similar characteristics as those identified with most of these economies. In the first instance, in addition to its primary objects, the CBN is also saddled with developmental functions as a result of the need for rapid economic development. Secondly, prior to the banking/financial sector reforms, the financial markets were shallow and banks were structurally oligopolistic. In addition, fiscal policy has over the years hampered monetary management largely due to its expansionary nature, thereby forcing the Bank to continually adjust its monetary programme to counter the adverse effect of fiscal dominance. Specifically, for most of the 1980s and 1990s, sporadic revenue sharing attended by unbridled fiscal expansions at all levels of government exerted intense pressure on monetary policy implementation. Consequently, several efforts were initiated by the monetary authority to solicit for better understanding from the fiscal authorities on the need to complement monetary management initiatives with fiscal prudence in order to engender a low inflationary environment that is critical for growth.

Beginning from 2001, the Federal Government in addressing the predicament of the monetary authority undertook a number of fiscal reforms including oil price budget benchmarking, due process etc which brought some levels of fiscal restraint. However, the ability of the government to sustain its efforts suffered setbacks as fiscal developments shortly afterwards became inimical to monetary processes. Therefore, the challenges to effective monetary management remained issues of fiscal profligacy and the need to properly co-ordinate fiscal and monetary policies for effective performance.

The purpose of this paper is to underscore the need for a predictable fiscal operations at all levels of government as a means of ensuring effective and efficient monetary management in the Nigeria federation. Following this introduction, section two discusses conceptual issues and the review of literature, section three discusses government's fiscal operations and challenges to monetary management, while section four examines fiscal reform and its impact on monetary management. Section five contains suggestion on the way forward and some concluding remarks.

2.0 Conceptual Issues and Review of Literature

2.1 Conceptual Issues on Fiscal Policy

Fiscal policy is the deliberate changes in the levels of government expenditure, taxes and other revenue and borrowing in order to achieve such national goals or objectives as price stability, full employment, economic growth and balance of payments equilibrium Okunrounmu (2003). The stance of fiscal policy could be neutral, which implies a balanced budget where government spending is equal to tax revenue; expansionary, where a government raises it's spending or reduces taxation, or a combination of the two; or contractionary, when government spending is reduced either through higher taxation or reduced spending (Wikipedia, 2010).

Monetary Policy

According to Mordi (2008), the term monetary policy refers to a blend of measures designed by the central bank to regulate the value, supply and cost of money consistent with the absorptive capacity of the economy or the expected level of economic activity without necessarily generating undue pressure on domestic prices and exchange rates. The objectives of monetary policy can vary from one country to the other, but are generally of two variants. The first focuses on single objective of price stability, while the second perspective has multiple objectives of achieving not only price stability, but other macroeconomic goals. The need to regulate money supply is based on the general consensus that the quantity of money supply and the general price level are highly related and if not regulated, could result in undesirable effects such as rising inflation. The control of money supply could be done through the use of direct instruments such as interest rates fixing, credit ceilings, directed lending and exchange rate controls or through the use of indirect instruments such as Open Market Operations (OMO), reserve requirements liquidity and cash reserve ratios, discount window operations, including standing deposit and lending facilities, among others.

2.2 Review of Relevant Literature

Monetary and fiscal policies are inextricably tied, suggesting that a sustainable fiscal policy and pragmatic monetary management are important to the realization of the objectives of growth and development of an economy. Both policies are essential components of overall macroeconomic policies and they usually shares similar goal of macroeconomic stability, low inflation and reduced unemployment. All these objectives, however, may not be achievable without trade-offs and also requiring a lot of coordination for policy effectiveness.

Zoli (2005) posited that fiscal policy could affect monetary policy through the impact of budget constraint, and also through the effect on a number of monetary variables such as interest and exchange rates. Sargent and Wallace (1981), submitted that excessive fiscal expansion (fiscal dominance) weakens monetary authority's ability to control inflation and also creates distortions for interest and exchange rates.

On the coordination of fiscal and monetary policy, Blinder (1983) stated that the lack of coordination usually stems largely from the following: the fiscal and monetary authorities having different objectives (the two authorities might have different opinions about the likely effects of fiscal and/or monetary policy actions on the economy) and; the two authorities making different projections on the likely state of the economy. Melitz (2002), estimated the reaction functions of the monetary and fiscal authorities on a pool of 19 OECD countries over the period 1960 1995 and found that monetary and fiscal policies have tended to move in opposite direction, which underscores the need for greater understanding of their interactions for effective policy development.

Sokoler (2002) in his study on the interaction between fiscal and monetary policy in Israel observed that the financial system showed remarkable resilience as evident in a stable foreign exchange market and inflation expectations which were within 1 3 per cent range. He noted that these impressive results were possible because both the fiscal and monetary policy were properly coordinated as they focused on reducing the deficit/government debt and maintaining price stability. Mutoti, (2005) noted that to reduce the conflict between monetary and fiscal policies necessitated the institution of the following: independence of the central bank; limiting central bank credit to the government; fiscal discipline, and; establishing developed financial markets.

3.0 Fiscal Operations and Challenges to Monetary Management

3.1 Fiscal and Monetary Policy Formulation

The main instrument of fiscal policy in Nigeria is the budget and is usually prepared by government ministries/departments/agencies (MDAs) of the federal government under the supervision and guidance of the Ministry of Finance (MoF), through the Budget Office of the Federation (BOF). Hitherto, the time horizon for the budget had been one fiscal year, until recently, when the medium term fiscal framework was introduced.

Under the current democratic dispensation, the budget estimates are collated and fine tuned by the MoF with due consultation with the Presidency and thereafter presented to the Federal Executive Council (FEC) for consideration. After its adoption by the FEC, the budget proposal (Appropriation Bill) is presented by the President to the joint session of the National Assembly. The Bill is deliberated upon in both chambers (House of Representatives and Senate) of the National Assembly, while the MDAs are frequently invited to defend their entries. After due consideration that may necessitate some amendments, approval is granted by the National Assembly and the Bill forwarded for consent of the President in order to become an Appropriation Act. Under the erstwhile military regimes, budgeting was exclusively the responsibility of the Supreme Military Council under the chairmanship of the military Heads of State. Under the military administrations, therefore, budget process was less tedious as decisions were made by the nucleus of the central command structure of the Nigerian Army and fewer persons were involved in the process. Over the past years to date, however, the main thrusts of the Federal Government fiscal policy (ies), irrespective of the regimes (military or civil), largely remains the pursuit of the primary goal of economic growth, employment generation and provision of infrastructure.

The authority to carry out monetary policy is vested in the CBN through the CBN Act 2007. This law, which repealed previous legislations on the matter, enjoins the Bank under Section 2 to ensure monetary and price stability, among others. In designing monetary policy, Ezema (2007) noted that the CBN reviews developments in the economy over a period, articulates the major pressures for and risk to price stability and formulates a framework which is essentially based on a monetary programme which sets out future trends in macroeconomic aggregates to guide its monetary policy implementation. The monetary programme is reviewed on the basis of the performance of macroeconomic aggregates against the projections. He also observed that monetary management generally focused on price stability through assiduous tracking of liquidity.

The role of the CBN in budgetary process is indirectly derived from its object under Section 2 (e) of the CBN Act 2007 as banker and financial/economic adviser to the Federal Government. Although the role of the Bank in the formulation of fiscal policy is essentially that of adviser, it is nevertheless assigned the major role of financing the fiscal deficits through the granting of temporary advances to the Federal Government as provided under Section 38 (1), subject to the limitation imposed by Section 38 (2) and (3a) of the Act.

In the context of the objectives of both the fiscal and monetary policies as enunciated, it is apparent that conflict will often arise between the CBN whose primary goal is to maintain monetary and price stability and the Federal Government whose primary pursuits are infrastructure provision, employment generation and economic growth. Therefore, proper coordination of monetary and fiscal policies is a key factor in achieving effective monetary management and is imperative in ensuring a stable macroeconomic environment.

3.2 Trend in Government Fiscal Spending

In over four decades, the fiscal operations of the government both at the national and sub-national levels have essentially been characterized by continuing growth in expenditure and have persistently followed the booms and burst pattern of earnings from the oil sector. The developments in crude-oil earnings have heightened the pro-cyclical nature of fiscal thrusts such that increase in revenue was most of the time followed by more than proportionate expansion in government expenditure. A cursory look at government outlay indicated that aggregate expenditure of the Federal Government grew at an annual average of about 40.5 per cent between 1990 and 1999, while those of the sub-national governments increased at an annual average of about 31.9 per cent over the same period.

Similarly, between 2000 and 2008, the expenditure of the federal and the sub-national governments grew at an annual average of about 16.5 and 41.9 per cent, respectively (Appendix 1). The fiscal expansion of the three tiers of government and the concomitant large fiscal deficits of the three tiers of in the 1990s militated against the efficacy of monetary policy. Thus, huge fiscal operations at all levels and the inflationary financing of large budgetary deficits of the Federal Government vitiated monetary management, particularly, as the CBN had to take-up an annual average of 36.7 per cent of the Federal Government's fiscal deficits with the issuance of high powered money (Appendix 2).

This condition subsequently created distortions in the financial markets as interest and exchange rates were misaligned throughout the period. The bourgeoning of government fiscal operations continued unabated from 2000 through 2008, however, there was moderation of fiscal expansion at the federal level owing to the introduction of fiscal reforms in 2003, while the rapid fiscal expansion persisted at the sub-national levels. Consequently, unbridled fiscal spending with the attendant fiscal deficits by all the tiers of government, over the years, engendered rapid monetary growth, accentuated inflationary pressure and vitiated the effectiveness of monetary management as monetary targets were missed by wide margins for most periods (Appendix 3).

Figure 1: Growth rate of public expenditures for Federal and Sub-national governments

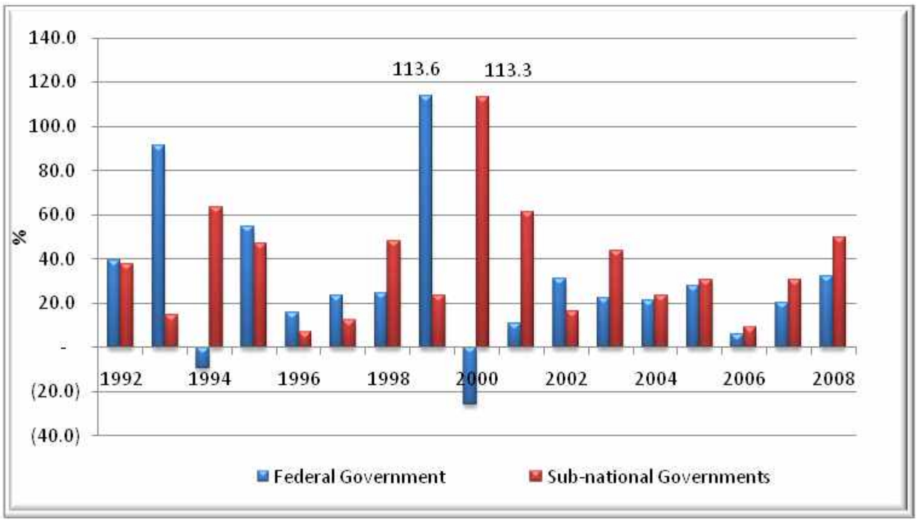


Figure 2: Percentage of CBN Take-Up of Federal Government Fiscal Deficit Financing

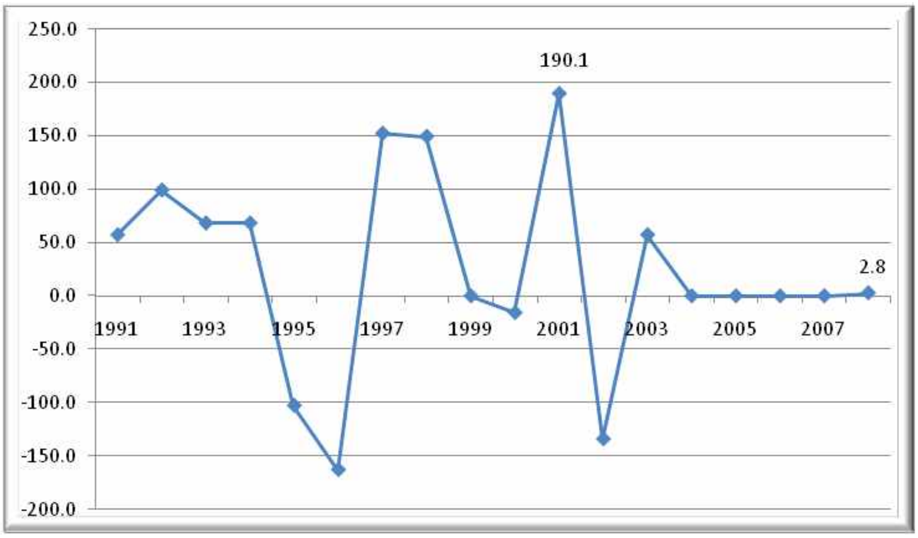
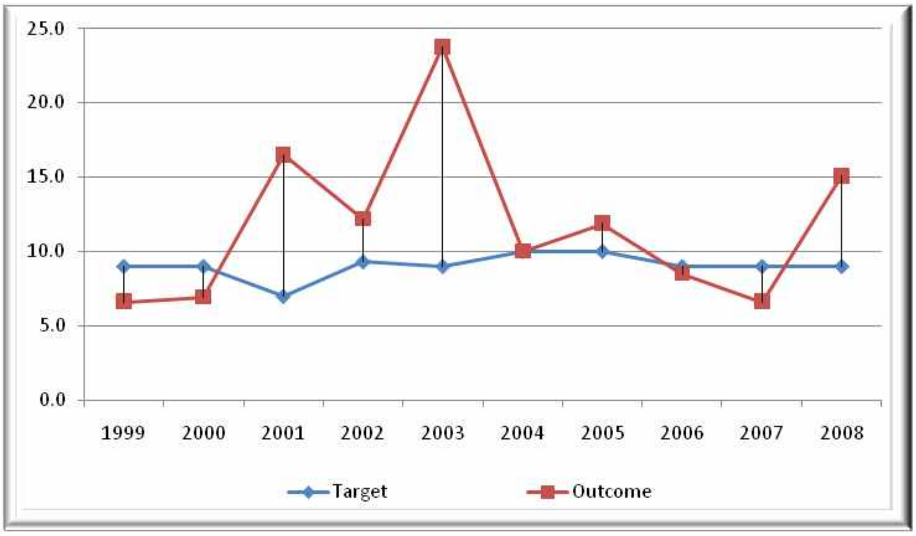


Figure 3: Inflation targets and outcomes



3.3 Challenges to Monetary Management

Several fiscal factors have overtime hampered the efficiency and effectiveness of monetary management by the CBN. These factors included the following:

♦ The financing of large fiscal deficits of the Federal Government mainly by the CBN through the "ways and means advances" particularly in the 1980's and substantial part of 1990's.

♦ Excessive fiscal spending by the three tiers of government due to the sustained increase in revenue flows from the Federation Account, occasioned by rising price of crude oil at the international market.

♦ Banking system borrowing by the sub-national governments to finance unplanned and inefficient extra budgetary activities.

♦ Unbridled fiscal expansion due to un-coordinated budgetary operations of the three tiers of government.

♦ The rapid monetization of crude oil earnings and other un-budgeted receipts.

♦ The provisions of Sections 162 (1-5) of the Constitution of the Federal Republic of Nigeria which stipulates outright sharing of all revenue that accrues to the Federation Account among the three tiers of government, making it impossible for effective prediction of fiscal injections into the economy.

• Persistent drawdown of the excess crude saving by the three tiers of government at unpredictable intervals raises their spending patterns

Given the resolute commitment to the mandate of ensuring monetary and price stability at all times, the CBN in the past three decades deployed several monetary instruments including the un-conventional ones to contain the problem of liquidity surfeit and rein-in inflation. Consequently, for most of the 1990s, the Bank deployed un-conventional instruments including stabilization securities, CBN certificates, special treasury bills, special deposits, withdrawal of public sector deposits from deposit money banks, in addition to the conventional instruments of open market operations (OMO), rediscount rate, reserve requirements, cash/liquidity ratios to achieve its objectives.
With continuing threats to monetary management emanating largely from fiscal shocks, the Bank introduced other complementary monetary management tools including repos, open buy-back (OBB), reverse repos, swaps, special OMO auctions, occasional foreign exchange swaps, special wholesale Dutch Auction System (wDAS) and standing deposits and lending facilities, among others, in the last half-decade, to liquidate intermittent liquidity upsurges. In 2006, the Bank re-engineered its policy framework by replacing the Minimum Rediscount Rate (MRR) which hitherto served as the nominal anchor for interest rates in the economy with the Monetary Policy Rate (MPR) in order to be more proactive in monetary management.

It is pertinent to emphasize that monetary management remained confronted with the problems of the non-committal to the Bank's ultimate target of inflation by successive governments. This posture always create difficulty for the pursuit of a low and stable inflation by the CBN, as the short term objectives of government is inconsistent with medium to long run objective of price and monetary stability.

4.0 Fiscal Reforms and the Efficacy of Monetary Management

Realizing that fiscal prudence is a pivot in achieving low inflation and stable macroeconomic environment, the Federal Government embarked upon a number of fiscal reforms beginning from fiscal year 2001 to ensure efficient use of resources. These included:

Fiscal Rule Oil price based fiscal rule by applying specific oil price benchmark for budgeting and the establishment of a savings fund known as the excess crude revenue account to warehouse excess revenue from crude oil sales above a predetermined oil price benchmark. This policy is aimed at ensuring that public expenditure is smoothened over time.

♦ Monetization of the benefits of public servants to stem the ever rising recurrent expenditure of the Federal Government, thus reducing waste and releasing more resources for the provision of social and economic infrastructure.

♦ Pension Reform Enactment of the Pension Act 2004 to free public resource from the burden of pension payments and institute fiscal affordability in public finance nationwide.

♦ Public Sector Procurement Reform The establishment of the Budget Monitoring and Price Intelligence Unit (BMPIU) 'Due Process' to ensure that procurement procedures are in line with best practices, guarantee value for money and maintain budget discipline.

♦ Introduction of policy based budgeting to ensure transparency and accountability and adherence to budget processes by law.

- Commencement of the medium term fiscal framework Medium Term Fiscal Framework (MTFF) embodying Medium Term Expenditure (MTEF), Medium Term Revenue Framework (MTRF) and Fiscal Policy Strategy (FPS) to drive budgetary processes.

- Enactment of the Fiscal Responsibility Act (FRA) 2007 to ensure prudent management of the nation's resources and engender long term macroeconomic stability.

Other complementary measures directed at ensuring fiscal discipline and support the efficacy of monetary management included:

♦ Entrenchment of a provision limiting the granting of advances to the Federal Government for budget support. Section 38, 1-3 of the Central Bank Act 2007 provided for the granting of temporary advances of not more than five per cent of the previous year's actual revenue of the Federal government and such shall be repayable at the end of the financial year in which it is granted. Furthermore, the Bank's power to grant such advances in any subsequent year is not exercisable unless previous advances have been paid.

♦ The West African Monetary Zone (WAMZ) primary convergence criteria requirement limiting government budget deficit/GDP ratio to 4.0 per cent and central bank financing of such deficit to 10.0 per cent of previous year's revenue has been helpful in containing fiscal extravagance.

The implementation and institutions of these reforms have so far yielded positive results particularly with regards to engendering macroeconomic stability and creating the enabling environment for monetary management to thrive. Specifically, the fiscal reforms had brought some element of prudent fiscal management particularly with respect to the size of fiscal deficits/GDP ratio which declined asymptotically from 1.5 per cent in 2004 to 0.6 per cent in 2007. Similarly, with regard to financing of fiscal deficits, the CBN zero tolerance for 'ways and means advances' was respected by the Federal Government as the Bank's deficit take-up was nil, except in 2008 when its took-up 2.8 per cent of the deficit (Appendix 2).

Notwithstanding these developments, the coordination of fiscal and monetary policy calls for constant re-examination of issues with respect to the overall liquidity in the economy. Given the high degree of vulnerability of the federation revenue to the vagaries of oil prices in the international market, a sustained downward swing in prices for instance could constitute a serious threat to the fiscal operations of all levels of government and may induce governments, particularly, the Federal Government, recourse to the CBN for financing of huge fiscal deficits. This may reverse the gains of the fiscal reforms and put monetary management at risk.

In the light of this, monetary authority should at all time not loose sight of the inherent danger posed by revenue volatility to government fiscal operations and ultimately, the effectiveness of monetary management.

5.0 Way Forward and Conclusion

The paper has examined the various ways in which government fiscal operations has constrained monetary management in Nigeria. It established the fact that huge public spending by the three tiers of government, over the years, had hampered monetary management resulting in the missing of monetary targets by wide margins, while induced serious pressure on the general price level. The paper also discussed the various fiscal reforms and examined the aftermath of the reform initiatives.

To further strengthen and improve the efficacy of monetary management, the following suggestions are instructive.

✓ The current efforts at strengthening transparency and accountability in fiscal management should be sustained to prevent undue constrains to monetary management. In this respect, strict adherence to the fiscal responsibility laws (FRA 2007) would continue to stimulate fiscal discipline and good public expenditure management.

✓ The continued observance of the Medium -Term Fiscal Framework (MTFF) and the newly introduced performance budgeting initiatives should be pursued with vigor to improve allocation and operational efficiency of government spending.

✓ Internal auditing of MDAs should be strengthened to inculcate financial discipline and promote efficiency in public expenditure management.

✓ The savings in the excess crude account should be strictly channeled to provision of socio-economic infrastructure including building transport infrastructure such as roads and rail, energy particularly power, health services to enhance human capital and support adaptable technological research so as to lay the foundation for industrialization and economic advancement.

✓ The government should initiate and pursue policies/reforms that would truly diversify Nigeria's revenue base to promote predictable earnings and engender a macroeconomic environment in which resources are efficiently utilized to ensure sustainable public finance at all levels of government.

✓ Sub-national governments should be encouraged to adapt and enact the relevant provisions of the FRA 2007. This would promote efficient public expenditure management, assist budgetary operations and ultimately foster the fiscal policy coordination nationwide.

✓ There is need to ensure that the fiscal operations of government do not result in excess liquidity beyond the absorptive capacity of the economy. In this respect, it is important to pursue consistent monetary-fiscal policy mix to achieve the desired macroeconomic objectives. Thus, arrangements for the sharing vital information to support the execution of both policies for effective monetary management should be fashion out and implemented.

✓ High powered committee involving public and private sector practitioners should be constituted to ensure the effective fiscal and monetary coordination and make recommendation to the Federal Executive Council (FEC).

Finally, the intention to rehabilitate the nation's dilapidated social and physical infrastructure by the Federal Government would require huge budgetary outlays and inevitably substantial injection of liquidity with serious implications for monetary management. Thus, fiscal authorities must ensure judicious use of resources in order to foreclose inefficient expenditure that could frustrate monetary authority's efforts at ensuring monetary and price stability. In addition, an enduring fiscal and monetary coordination should be instituted by both authorities through reconciliation of common objectives and the pursuit of complementary actions to realize them.

APPENDIX 1

Public Expenditure (₦' Billion)

Pub Exp/Yr	1991	1992	1993	1994	1995	1996	1997	1998	1999
Fed. Govt.	66.6	92.8	177.3	160.9	248.8	288.1	356.3	443.6	947.7
Sub-Nat	27.0	37.1	42.5	69.4	102.0	108.9	122.2	181.2	223.5
Total	93.6	129.9	219.8	230.3	350.8	397.0	478.5	624.8	1171.2

Source: CBN Statistical Bulletin

Public Expenditure (N Billion)

Pub Exp/Yr	2000	2001	2002	2003	2004	2005	2006	2007	2008
Fed. Govt.	701.1	1018.0	1018.2	1242.8	1504.2	1919.7	2038.0	2450.9	3240.8
Sub-Nat	476.7	768.3	894.3	1282.9	1586.2	2066.6	2252.6	2943.5	4403.6
Total	1177.8	1786.3	1912.5	2525.7	3090.4	3986.3	4290.6	5394.4	7644.4

Source: CBN Statistical Bulletin

APPENDIX 2

Fiscal Indicators

Pub Exp/Yr	1991	1992	1993	1994	1995	1996	1997	1998	1999
FG Deficit	-35.76	-39.53	-65.16	-70.27	1.0	32.05	-5.0	-133.4	-285.1
CBN Take-Up (%)	57.4	99.4	68.4	68.5	-103.0	-163.2	152.7	149.8	0.0

Source: CBN Statistical Bulletin

Fiscal Indicators

Pub Exp/Yr	2000	2001	2002	2003	2004	2005	2006	2007	2008
FG Deficit	-103.78	-221.05	-301.40	-202.72	-172.60	-161.41	-101.40	-117.24	-47.38
CBN Take-Up (%)	-15.7	190.1	-134.3	57.4	0.0	0.0	0.0	0.0	2.8

Source: CBN Statistical Bulletin

APPENDIX 3

Key Monetary Management Variables (%)

Particulars	1991		1992		1993		1994		1995		1996	
	Tgt.	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.
M1	14.6	32.6	24.3	52.8	20.0	57.5	21.4	46.7	9.4	15.4	14.5	18.0
M2	14.6	32.7	26.8	49.8	18.0	53.8	14.8	34.5	10.1	19.4	16.8	16.2
Inflation	n.a	13.0	n.a	44.5	n.a	57.2	n.a	57.0	n.a	72.8	n.a	29.3
RM	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a

Source: CBN Annual Reports

Key Monetary Management Variables (%)

Particulars	1997		1998		1999		2000		2001		2002	
	Tgt.	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.
M1	13.5	10.6	10.2	17.2	4.1	19.9	9.8	62.2	4.3	28.1	12.4	15.9
M2	15.0	16.0	15.6	22.3	10.0	31.4	14.6	48.1	12.2	27.0	15.3	21.6
Inflation	n.a	8.5	n.a	10.0	9.0	6.6	9.0	6.9	7.0	16.5	9.3	12.2
RM	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	14.0

Source: CBN Annual Reports

Key Monetary Management Variables (%)

Particulars	2003		2004		2005		2006		2007		2008	
	Tgt.	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.	Tgt	Outc.
M1	13.8	29.5	10.8	8.6	11.4	29.7	13.3	32.2		36.6		55.9
M2	15.0	24.1	15.0	12.3	15.0	24.4	13.3	43.1		44.2		57.8
Inflation	9.0	23.8	10.0	10.0	10.0	11.9	9.0	8.5	9.0	6.6	9.0	15.1
RM	n.a	19.8	12.8	5.2	6.5	4.2	7.5	27.6	3.3	48.6	26.0	29.6

Source: CBN Annual Reports.

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