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INFLATION AND UNEMPLOYMENT NEXUS IN NIGERIA: *ANOTHER TEST OF THE PHILLIP'S CURVE*

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ABSTRACT

This research work examines the inflation and unemployment nexus in Nigeria by testing if the original Phillips curve proposition holds for Nigeria. The study adopted a distributed lag model with data covering the period 1970-2011. The consumer's price index (a measure of inflation rate), was regressed on unemployment rate, growth rate of money supply, budget deficit, real gross domestic product, interest rate and the lag of current interest rate. The result reveals that unemployment is a significant determinant of inflation and that there is a positive relationship between inflation and unemployment rate in Nigeria. This finding invalidates the original proposition on the Phillips curve hypothesis in Nigeria. The study therefore recommends that the economy should be diversified and appropriate policies should be put in place by Government and the monetary authorities in order to curb the menace of inflation and unemployment and consequently reduce the problem of stagflation in Nigeria. Again, there is a need for strong institutional collaboration in dealing with these two macroeconomic variables; unemployment and inflation as have been recommended in the paper.

Keywords: Inflation, Unemployment, Hypothesis, Determinants, Philips curve, Nigeria.

JEL Classification: E24, E31, P24.

Contribution/ Originality

This study contributes to the existing literature by using a distributed lag model to Inflation and Unemployment Nexus in Nigeria. The result reveals that there is a positive relationship between inflation and unemployment rate in Nigeria. This finding invalidates the original proposition on the Phillips curve hypothesis in Nigeria.

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1. INTRODUCTION

Inflation and unemployment remain burning issues in any economy. All policymakers would to a large extent, wish to have low rates of inflation and unemployment. It is often argued that a single-digit rate of inflation and an unemployment rate of about five per cent would ensure macroeconomic stability in an economy all things being equal. Macroeconomic stability is essential for growth, planning and development, hence the desirability of examining the movement of other economic fundamentals if the goal of stability will be achieved.

Inflation, which connotes the general increase in the price level, is broadly an average measure because at any point in time, prices may be increasing, decreasing or constant; a persistent increase in prices hurts the economy, particularly the poor who have little or no savings to cushion rising prices. The average person in any household or family knows when the money in his possession can only purchase less quantity of goods and services than was previously possible. Generally, economic agents (households, private sector and government) would raise an alarm because their earnings have declined in real terms due to rising prices. It is even worse when uncertainty follows price increases. (Nwaobi, 2009)

In recent times however, the concern is no longer with single-digit rates of inflation (less than 10 per cent) but with the benchmark desirable for any economy. Recent research results show that the inflationary threshold for Nigeria is between 14 to 18 per cent, so why the frenzy over a single-digit rate of inflation? It is interesting to note that even very low rates of inflation (disinflation) can be harmful to an economy but the question is which rate is very low?

Another interesting variable is how inflation is measured? What are the types of goods and services that enter the basket? Which method is used in computing the rate of inflation? The extent of the survey is crucial and so are several other issues.

In Nigeria, the mandate of the Central Bank is to ensure price stability while the National Bureau of Statistics computes and publishes the rates of inflation for all items in the economy – food, manufacturing, transport, etc. Economists in Nigeria have shown through research that inflation in the country is caused by several factors such as increased public spending, money supply, intermittent scarcity, announcement effect, removal of petroleum subsidy, etc. Looking at the Nigerian data, the rate of inflation which stood at 21.4 per cent in 1980 plummeted to 7.2 per cent a year after but by 1983, it had jumped to almost 41 per cent. During the Structural Adjustment Program era (1986 -1992), the rate of inflation averaged 31.5 per cent. From 1995 to 2007, it averaged 12.3 per cent (a period characterized by a democratic experiment and the bold effort at a better management of the economy). During the period 2008 to 2011, the rate of inflation stood at 12 per cent. The inflationary trend shows that it has been non-linear overtime.

Another disturbing but significant macroeconomic variable is the rate of unemployment. A high rate of unemployment connotes output loss to the economy. The rate of unemployment captures the percentage of those willing and able to work but cannot find employment, it captures the frequency duration and incidence of unemployment. In Nigeria, early statistics on unemployment should not be taken seriously because the data indicated that the economy was at