Unisia
2022, Vol. 40, No. 1, 129-146
https://doi.org/10.20885/unisia.vol40.iss1.art6

Fiscal Policy, Monetary Policy, and Trade Balance Nexus in Nigeria: A New Empirical Evidence

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ABSTRACT
Today fiscal and monetary policy instruments are inextricably linked in macroeconomic management as the macroeconomic variables are interwoven. The broad objective is to analyze the impact of fiscal and monetary policy instruments on the trade balance in Nigeria. This study uses the cointegration method and ordinary least square estimation to examine the impact of fiscal and monetary policy on Nigeria's trade balance from 1981 to 2018. The co-integration test confirms the existence of a long-run relationship between monetary policy as measured by broad money supply and fiscal policy as measured by government spending, taxation, and trade balance. The empirical findings revealed that the selected monetary and fiscal policy variables did not improve Nigeria's trade balance during the study period. As a result, the study recommended that the government encourage trade policies that increase exports to attract foreign exchange inflows and foreign investments.

Keywords
export; fiscal policy; import; monetary policy; trade balance
JEL Classification: E51; E62; F1; F31; H61

Citation: Nwagu, G. U., Orji, A., Jude, I. O., Ogbuabor, J. E., Anthony-Orji, O. I., & Nwufo, L. C. (2022). Fiscal Policy, Monetary Policy, and Trade Balance Nexus in Nigeria: A New Empirical Evidence. *Unisia, 40*(1), 129-146. https://doi.org/10.20885/unisia.vol40.iss1.art6

ARTICLE HISTORY
Received January 18, 2022
Revised August 4, 2022
Accepted August 6, 2022
Published August 22, 2022

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INTRODUCTION

Discussions on monetary and fiscal policy issues have been very prominent in economic literature and among policy analysts over the past few decades. In Nigeria, the use of fiscal policy measures for economic management has been affected by the rising level of public debt triggered by the expanding budget deficits. Again, the effective use of fiscal policy measures in Nigeria over the years has been influenced by the pattern of public spending, tax regime, and the overall management of the fiscal framework in the short and long term. According to the Central Bank of Nigeria (CBN), the goal of fiscal and monetary policy is to achieve government economic objectives, which include full employment, high output or high output growth, a stable exchange of rate, a stable price level or a low inflation rate and balance of payments (Central Bank of Nigeria, 2021).

Imbalances in monetary, fiscal, and trade flows have been challenges for policymakers throughout history. Fiscal and monetary policies are major economic policy instruments that macroeconomists and policymakers use to address these problems. Government expenditure and money supply are the major instruments of both policies. Government budget balances can affect the trade balance. A trade deficit always occurs when there is a net inflow of foreign financial investment, while a trade surplus always occurs when there is a net outflow of foreign financial investment. In Nigeria, the Central Bank of Nigeria is charged with the task of implementing the monetary policies of the government. Over the years, the objective of monetary policy in Nigeria has been the attainment of internal and external economic balance (Odungweru & Ewubare, 2020). To execute monetary policy, the CBN uses instruments such as open market operations, discount rates, liquidity ratios; cash reserve ratios, selection credit control exchange rate, and moral suasion. The monetary policy in this regard is highly important; it not only maintains the internal targets of the economy but also monitors the external balance. Countries trade with each other to obtain things that are of better quality or less expensive or simply different from the goods and services produced at home.

A change in the exchange rate helps the monetary authority achieve external balance. In a deficient trade balance, an exchange rate adjustment can be useful. Theoretically, developing countries may need some devaluation to benefit from international trade in the long run. The improvement in the trade balance may, however, not be immediately apparent. Before it can show improvement, it needs to undergo some adjustments. The first adjustment happens during periods of currency depreciation when the trade balance deteriorates. Since initially trade contracts were fixed over