IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 11, Issue 1 Ser. IV (Jan – Feb 2020), PP 55-60
www.iosrjournals.org

Effect of Fiscal Policy on the Performance of Banks in the Nigerian Economy

Isek, Friday Cosmos[1], Odumusor, Charles Joseph[2], Idor, Roy Michael[3]
[1]*Department of Accountancy Faculty of Management Sciences Cross River University of Technology*
[2]*Department of Accountancy Faculty of Management Sciences Cross River University of Technology*
[3]*Department of Accountancy Faculty of Management Sciences Cross River University of Technology*

Abstract: *This paper investigated the effect of fiscal policy on the performance of banksin the Nigerian economy. This was to ascertain the factors that influenced the sector performance of banks using bank's return on equity as proxy for bank performance. The study period covered 26 years from 1990 to 2015, using selected indicators and employing the ordinary least squares (OLS) regression technique. We tested the null hypotheses of no significant relationship between return on equity and chosen indices of factors that have effect on bank performance, namelygovernment total expenditure(GTEXP), and government tax revenue (GTR). Results showed that overall; fiscal policy has a significant effect on the banks profitability, meanwhile, on individual basis, it was discovered that Government tax revenue (GTR) and government total expenditure (GTEXP)had a positive and significant influence on the banks performance in Nigeria economyusing return on equity as a proxy. It was concluded therefore that fiscal policyplays a vital role in determining the volume of bank's profitability in Nigeria. It was recommended that government and its monetary authorities should formulate better fiscal policy to encourage economic development of the banks.*

Keyword: *Government Total Expenditure, Government Tax Revenue, Return on Equity, Fiscal Policy and Bank Performance.*

Date of Submission: 29-01-2020 Date of Acceptance: 14-02-2020

I. Introduction

Governments use fiscal policy to influence the level of aggregate demand in the economy, in an effort to achieve economic objectives of price stability, full employment, and economic growth. Keynesian economics suggests that increasing government spending and decreasing tax rates are the best ways to stimulate aggregate demand, and decreasing spending & increasing taxes after the economic boom begins. Keynesians argue this method be used in times of recession or low economic activity as an essential tool for building the framework for strong economic growth and working towards full employment.

The effect of fiscal policy on growth has generated large volume of empirical studies with mixed findings using cross sectional, time series and panel data. Fiscal policy is generally believed to be associated with growth, or more precisely, it is held that appropriate fiscal measures in particular circumstances can be used to stimulate the performance of banks and development (Khosravi and Karimi, 2010).

Governments can use a budget surplus to do two things: to slow the pace of strong economic growth, and to stabilize prices when inflation is too high. Keynesian theory posits that removing spending from the economy will reduce levels of aggregate demand and contract the economy, thus stabilizing prices.

An activist macroeconomic policy involves setting monetary and fiscal variables in each time period at the values which are thought necessary to achieve the government's objectives. A basic premise of Keynesian economics is that the private sector is inherently unstable. It is subject to frequent and quantitatively important disturbances in the components of aggregate demand. It is the task of counter cyclical or stabilization policies to offset these private sector disturbances and so keep real output close to its market – clearing equilibrium time path (Omitogun and Ayinla, 2007).

The concept of a fiscal straitjacket is a general economic principle that suggests strict constraints on government spending and public sector borrowing, to limit or regulate the budget deficit over a time period. Nigeria does not a have balanced budget rules that prevent them from running a deficit on like United State. The United States federal government technically has a legal cap on the total amount of money it can borrow, but it is not a meaningful constraint because the cap can be raised as easily as spending can be authorized, and the cap is always raised before the debt gets that high.

Fiscal policy is concerned with the determination of the type, time and procedures to be following in obtaining government modern fiscal policy analysis. It is largely concerned with effect and different method of obtaining revenue and different expenditure on prices, consumption, employment and the manner in which income of a nation is divided among the citizen (Lendhom 1998) it is posted that the main cause of excess liquidity in the monetary system and it adverse effects is budget deficit of government both at the federal and state levels of various economy.

It has been clearly recognized that the discussion of the effect of particular taxes and particular types of government expenditure is only part of the subject matter of public finance and therefore, all fiscal operations are geared toward enhancing the living standard of the general public of the government of the day. Onuigbo (2002) has said emphatically that "fiscal control concerned with issues connected with budgeting debt management and taxation policies of government. It is a techniques of control of the economy as a whole through the use of government borrowing powers as well as manipulating of import and export duties, tariffs and quota", the above means that Onuigbo (2002) is in agreement with the fact that the government revenue techniques and expenditure control are fiscal operation used by the government to stabilize the economy.

In practice fiscal dominance occurs when fiscal policy is set exogenously to monetary policy in an environment where there is a limit to the amount of government debt that can be held by the public. Hence, if the inter-temporal budget constraint must be satisfied, fiscal deficits would have to be magnetized, sooner or later Thus in countries with shallow financial systems, monetary policy is the reverse side of the coin of fiscal policy and can only play an accommodative role. In such low income countries, government securities markets are underdeveloped and central banks do not hold sufficient amounts of tangible securities and the central bank's lack of suitable and adequate instruments of monetary control constitutes one of the factors that induce fiscal dominance

Where fiscal dominance applies, the country's economic policy is only as good as its fiscal policy and institutionalized central bank independence may not necessarily bring about an independent monetary policy (Oyejide, 2003).

The history of the introduction of fiscal policy method of controlling or stabilizing the economy dates back to the work of John Marynard Keynes despite the earlier theories of his masters, Jean Baptist a French economist who lived between 1767 and 1832, who said that spending (demand) would always be sufficient to justify (i.e production) at full employment gross national product (GNP). But in 1936, from the professorial Chair on Cambridge University, John Maynard Keynes, the wizard of finance, wrote in his famous treaties "theory of employment, interest and money in which he rebelled against the conventional views of his earlier teachers, Lord Keynes and his followers argued that the government budget is the appropriate weapon needed to control the economy. When demand is adequate, government expenditure should best step up and or taxation reduce and when demand is excess, expenditure should be cut and, or taxation increased to reduce people purchasing power.

Fiscal policy is a system by which a government ascertain its level of spending in order to monitor and influence a nation's economy. It is used along with the monetary policy which the central bank uses to influence money supply in a nation.

He seems to agree with the fiscal list but added for effective planning of the economy, other policies must be taken into consideration. But Shapino (1992), while enumerating the history and need for a government investment in the management of the economy, said that "the deliberate use of federal government spending and taxing as a possible means of attaining and maintaining full employment, a stable price level, and a satisfactory rate of growth data back to fifty (50) years. Hence, fiscal policy is a major economic stabilization weapon that involves measure taken to regulate and control the volume, cost and availability as well as direction of money in an economy to achieve some specified macroeconomic policy objective and to counteract undesirable trends in the Nigerian economy

1.2 Objectives

1. To find out the effect of government total expenditure on return on equity

2. To examine the effect of government tax revenue on return on equity.

1.3 Questions

1. To what extent does government total expenditure affect return on equity
2. How does government tax revenue affect return on equity?

1.4 Hypotheses

Ho1: There is no significant relationship between government total expenditure and return on equity.

Ho2: There is no significant relationship between government tax revenue and return on equity.

II. Literature

Fiscal policy as a policy that disrupt an existing system with regards to distribution of wealth in the economy and tries to correct the imbalance of being suspected. On his part, Lipsey and Schmidt-hebbel (2002), said that fiscal policy is defined as the use of the central authorities of government revenue and expenditure in an effort to influence the circular flow of income. Lipsey and Schmidt-hebbel therefore, are in agreement with redistribution of income through the fiscal policy tools when appropriately used. They further said that, when government tried to restrict its expenditure during slump because its tax revenue is falling at that time, on the other hand, during boom, when its revenue is high and rising, it increases its spending.

By fiscal policy, we mean the process of shaping taxation and public expenditure in order to;

i. Help to damped the savings of the business cycle

ii. Contribute toward the maintenance of a growing high employment free from volatile inflation.

Umoh (1993), contends that the government of any nation has the economic policies among which is the fiscal policy and this policy relates to the variability in the revenue and expenditure items of the nation financial statement. A discussion on the nature of fiscal policy cannot be complete without mentioning the two essential elements of fiscal policy which are discretionary and non-discretionary.

2.1 Objective of fiscal policy

These are the stated objectives:

1. To increase employment opportunities or to attain full employment.

Government usually aim at the smallest percentage of unemployment which the nation can reasonably hope to maintain in the light of structural changes in the economy.

2. Price stability: Fiscal policy aims at stabilization of price in the economy that is avoiding inflation and deflation. Expansionary Fiscal issues to fight inflation, taking into cognizance the aim of attaining full employment
3. To promote economic growth and development: This is one of the primary objectives of fiscal policy, the achievement of steady growth in natural resources and in national output as well as structural and attitudinal changes in the economy.
4. To attain or achieve equity in income redistribution: Fiscal policy is used to redistribute income so as to achieve equity and for the attainment of social and economic justice.
5. To achieve a satisfactory favourable balance of payment: Fiscal policy is used to avoid or correct balance of payment deficit in nations external trade relations

2.2 Functions of fiscal policy

Although particular tax and expenditure measures affect the economy in so many ways and may be designed to serve a variety of purposes, several or less distinct policy objectives may be set forth which now rank as the functions of fiscal policy.

These functions would be discussed using the following sub-headings

(a) **Allocation function**: This refers to the provision of social goods or process by which total resources used is divided between private and social goods and by which the mix of social goods is chosen.

The basic reason for market failure in the provision of social goods is the need for such goods being felt collectively whereas, that of private goods is felt individually, while people's preference an influenced by their social environment in lost last wants and preference are experienced individually and not by society at large.

The linkage therefore between producers and consumers is broken and the government must step in to provide for such goods. This is the political process entering the picture as a substitute for market mechanism.

b. Distribution function: The distribution of income based on the distribution factor endowment is determined by the process of factor pricing, which in a competitive market, sets factors returns equal to the value of the marginal product.

But even if all factors prices including wage and other returns personal services were determined competitively, the resulting pattern of distribution might not be acceptable.

c. Stability function: Having dealt with the bearing of budget policy on matter of allocation and distribution, we must now examine its role as an instrument of macro-economic policy. Fiscal policy must be designed to maintain or achieve the goods of high employment, a reasonable degree of price level stability, slowness of foreign account, an acceptable rate of economic growth and development. Without the economic trends to be subjected to substantial fluctuations and it may suffer from sustain period of unemployment or inflation (Varghese, 2002).

2.3 Instrument of fiscal policy

Fiscal policy instruments are broadly classified into two namely:

(a) **Automatically fiscal stabilizers:** Are among the most interesting instruments in the government antitypical kits or those ingenious devices that help to bring the economy back to an even level without a deliberate action on the part of anyone.

These are designed to function in a countercyclical fashion to improve the performance of the economy.

b. Discretional fiscal policy measure: Are those actions which have been designed by a legislative or executive action in order to deal with the problem at hand.

Their effectiveness is impaired by inaccurate economic forecast as well as lack of promptness on the part of the legislature to enact discretionary measures and the time it takes the executive to put them into effect.

Thus, discretionary measures require speed of decision and effect and can be successful in temporal and reversible fiscal changes for stabilization purposes are distinguished from permanent and structural changes.

Discretionary fiscal policy includes:

Tax transfer scheme: Attempts to help one group of individuals often have unintended consequences on the other group 'incentive matter' and it is necessary to have some idea of how behaviour is likely to change when the incentive structure changes.

Example attempt to redistributed income using progressive tax's and restricted by adverse incentive effect on both low income and high income group.

Tax on goods: This is another fiscal device used in redistribution of income between the rich household and the low income household. This is always in the form of value added tax (VAT). Vat is a tax levied upon a goods at a percentage of its value".

Budget: A budget is a plan used in financial forecasting, it is detailed statement of estimates in numerical terms, of the scale of operation in some phase of activity in some period. A budget is an instrument of fiscal policy in that, all revenues and expenditure of the government within a fiscal period is contained in it.

2.4 Fiscal policy problems in Nigeria

The main problems facing Nigeria in the successful application of fiscal policies include;

i. Timing problem: Correct timing of any programme in Nigeria is very difficult to achieve, because there are many lags between making and implementing fiscal policy which the following heading will explain;

ii. The recognition lag: It indicates time difference between the occurrence of the problem and its manifestation in the statistical trends. According to Umoh (1993), the problem is compounded in Nigeria because its statistical infrastructure and database are extremely poor.

iii. The administration lag: This refers to the waiting period between the recognition of the problem and taking of definite decision to act on it. This lag is mainly caused by the democratic slow process of decision making.

2.5 Theoretical framework

Anticipated income theory: This theory states that banks should involves themselves in a broad range of lending which may include long-term loans to business, consumer instalment loans and amortized real estate mortgage loans considering the fact that the likelihood of loan repayment which generates a cash flow that supplement bank liquidity depends on the anticipated income of the borrower and not the use made of the funds per se. This implies that a high excess reserve increases profitability of banks by increasing the availability of loanable investment funds.

Between 1970 and 1989, Fiscal Policy aimed at making available for financing economic development as the maximum flow of materials resources consisting with minimum consumption requirement containing inflationary pressure, raising additional revenue, minimizing existing inequalities in wealth, income and consumption standard may tend to undermine production efficiently, offend a sense of social justice and endanger stability, encouraging domestic production and subsequently reduce government budget deficit.

Others are leasing the continued heavy dependency on the oil sector as the main source of foreign exchange earnings and government revenue, reduction of the heavy burden of the both external and internal debts, generation of employment, reduction of over stressed economic and social infrastructures and the distorted pattern of both domestic consumption and production.

The main fiscal policy instrument in Nigeria include changes in taxation rate, government expenditure and public debt.

In the area of Personal Income Tax (PIT) before the take-over of government by the Military in 1966, the (PIT) rates and personal deductions determination was under the jurisdiction of the regional governments.

2.6 Empirical review

Punita and Somaiya (2013) carried out a research on the impact of monetary policy on the profitability of banks in India between 1995 and 2000. The monetary variables were banks rate, lending rates, cash reserve system and statutory ratio, and each was regressed on banks profitability independently. Lending rate was found to exact positive and significant influence on banks' profitability, which indicates a fall in lending rates will reduce the profitability of the banks. Also, bank rate, cash reserve system and statutory ratio were found to have negative and significant effect on the profitability of banks. Their findings were the same when lending rate, bank rate, cash reserve system and statutory ratio were pooled to explain the relationship between banks profitability and monetary policy instruments in the private sector.

Okoye and Eze (2013), examined the impact of bank lending rate on the performance of Nigerian Deposit Money Banks between 2000 and 2010. It specifically determined the effects of lending rate and monetary policy rate on the performance of Nigerian Deposit Money Banks and analyzed how bank lending rate policy affects the performance of Nigerian deposit money banks. The result confirmed that the lending rate and monetary policy rate have significant and positive effects on the profitability of Nigerian deposit money banks.

III. Methodology

3.1 Research design

The study adopted in this research work is the descriptive research design, because the researcher seeks to empirically investigate the effect monetary and fiscal policies using government total expenditure (GTEXP), government tax revenue (GTR),as the independent variables; while banks performance as the dependent variable with return on equity as the relevant profitability indicator controlling the independent variables. The method of data collection adopted in this study is the secondary method to see if positive or negative relationship still exist between dependent and independent variables on the effect of monetary and fiscal policies on the performance of banks. And the secondary method of data collection entails obtaining data from the records of institutions that collect and publish data/statistics as part of their routine duties. Government agencies such as the Federal Office of Statistics, now known as the National Bureau of Statistics, Central Bank of Nigeria (CBN), Federal Ministry of Finance, among others, are the most important and reliable routine compilers and suppliers of statistical data in Nigeria (Oaikhenan, & Udegbunam, 2004).

3.2 Specification of model

This study specifically will employ multiple regression analysis with OLS econometric technique for data analysis to empirically verify whether a significant positive relationship exists between the dependent variable (Return on Equity) and the independent, government total expenditure (GTEXP), and government tax revenue (GTR) and in the banking sector performance.

Therefore, making model which examines the effect of fiscal policy on the performance of banks in Nigeria are formulated as follows;

The model that captures the effect of fiscal policy on the performance of banks is specified thus:

ROE= f (GTEXP, GTR)……………..………..…............. (3.1)

In econometrics, equation 3.1 can be transformed as:

$ROE=\delta_0+\delta_1 GTEXP+ \delta_2 GTR+\varepsilon i$…..…................................... (3.2)

Where:

ROE = Return on Equity

GTEXP = Government Total Expenditure

GTR = Government Tax Revenue

δ_0 = Intercept term for model respectively

δ_1, - δ_5= Parameters to be estimated in model one

εi= Stochastic term or error term

The behavioural assumptions, the a priori, or the presumptive signs are stated as follows:

$\delta_1>0$, $\delta_2>0$, for the model

IV. Data Analysis

In table 4.1, the result of the trace statistic above indicates one (3) co-integrating equations at 5% level. Also the Max-Eigen value test indicates two (2) co-integrating equation. This can also easily be seen as two of the Max-Eigen Statistic values are greater than their critical values at 5% level. This reveals that there is a long-run relationship among the variables employed in the model

Having confirmed the fact that all the 1(1) variables are co-integrated in model, we proceed to estimate the error correction model.

Table 4.1: Unit Root Test (Augmented Dickey-Fuller Unit Root Test)

Variables	Level	First Difference	second difference	Lag(s)	Model	Order of integration
ROE	-2.949631	-		1	Trend and drift	(1)
GTEXP	-1.862685	6.120813***		1	Trend and drift	(1)
GTR	-1.421721	-		1	Trend and drift	(1)
ECM	-3.41529***	-6963207***		1	Trend and drift	(1)

Source: Author computation

Note: *(**) *** denotes statistically significant at 1%, 5% and 10% level respectively.

The data presented in table 4.1.show the test of stationarity of the variables employed in this study.

It is necessary to test for the stationarity of variables before using them in any regression in econometric analysis. This is because whenever a non-stationary time series is regressed on another or other non-stationary time series, the result is always a spurious regression result.

From the results obtained in ADF unit root test as evident in table 4.1, shows that LR has no unit root problem at level; while ROE, GTEXP, GTR, IR and are stationary at their first difference thus agrees with the fact that most macroeconomic variables are not stationary at level of 1%, 5%.

V. Conclusion& Recommendations

From the findings in the study, it was revealed that Government Total Expenditure (GTEXP) significantly influences the performance of Banks' Lending Rate through the mechanism of interest rate. Following the scope of this present study from 1990-2015; there is need for further research in this area to be extended from 2015 to 2025 for a better result on this sector of the Nigerian economy. Since this study could not cover up to 2025.

Also identify the channels through which Fiscal policy influences the profitability of banking sector in the Nigerian economy by examining the changes in banks lending rate and its results in the changes of Fiscal policy and also articulate policies that will enhance the effectiveness of Fiscal policy on commercial banks performance in the banking sectors in the Nigerian economy.

References

[1]. Khosravi, A. & Karimi, M. S. (2010). To Investigate the relationship between monetary policy, fiscal policy and economic growth in iran: autoregressive distributed lag approach to cointegration. American Journal of Applied Sciences, 7(3), 420 - 424.

[2]. Lendhom, T. (1998). Regulatory oversight and stakeholder protection. A Paper presented at the BGL mergers and acquisitions interactive seminar, held at Eko Hotels & Suites. V. I., on June 24.

[3]. Lipsey, N. & Schmidt-hebbel K. (2002), Monetary policy functions and transmission mechanisms: an overview. Central Bank of Chile

[4]. Oaikhenan, M. O.& Udegbunam (2004). The Nigerian economy at the cross roads: Policies and their Effectiveness. Calabar Saesprint publishers, 46 – 50.

[5]. Okoye, V. & Eze, O R (2013). Effect of bank lending rate on the performance of Nigerian deposit money banks, International Journal of Business and Management Review, 1(1), 34-43

[6]. Onuigbo, F. N. (2002). The Dynamics of the Nigerian financial system. Lagos: Amfitop publishers limited Omitogun, O & Ayinla, T.A (2007). Fiscal policy and Nigerian economic growth. Journal of Research in National Development. 5 (2) December

[7]. Oyejide, T. (2003). The Changes of monetary management in an environment of fiscal policy conference proceding on issues in fiscal management: Implication for monetary policy in Nigeria. 11-12 December 2003. Lagos CBN publication.

[8]. Punita, R.& Somaiya, K.J. (2013). Monetary policy: Its Impact on the profitability of banks in India. Intermediate Business and Economics Research Journal; Volume 5, Number 3, Pg. 15-19.

[9]. Shapino, A. C. (1992). Multinational financial management. Boston: Wiley, John & Sons. 8th edition

[10]. Umoh, O. A. (1993). Banking sector reforms & Bank consolidation: The Malaysian experience. Bullion, 29(2).

[11]. Varghese, W. S. (2002). Bank management & financial service. New York: McGraw Hill.

[12]. Central Bank of Nigeria Statistical Bulletin 2015 edition

Isek, Friday Cosmos, etal. "Effect of Fiscal Policy on the Performance of Banks in the Nigerian Economy." *IOSR Journal of Economics and Finance (IOSR-JEF)*, 11(1), 2020, pp. 55-60.