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**ECO 304.**

**PUBLIC SECTOR ECONOMICS.**

**QUESTION 1.**

1. THEORIES OF PUBLIC EXPENDITURE AND THEIR APPLICABILITY TO NIGERIA.

* Wagner’s Law

Wagner’s Law is named after the German political economist Adolph Wagner (1835-1917), who developed a “law of ever-increasing state activity” after empirical analysis on Western Europe at the end of the 19th century. He argued that government growth is a function of increased industrialization and economic development. Wagner stated that during the industrialization process, as the real income per capita of a nation increases, the share of public expenditures in total expenditures increases. The law cited that “The advent of modern industrial society will result in increasing political pressure for social progress and increased allowance for social consideration by industry.”

Wagner (1893) designed three focal bases for the increased in state expenditure. Firstly, during industrialization process, public sector activity will replace private sector activity. State functions like administrative and protective functions will increase. Secondly, governments needed to provide cultural and welfare services like education, public health, old age pension or retirement insurance, food subsidy, natural disaster aid, environmental protection programs and other welfare functions. Thirdly, increased industrialization will bring out technological change and large firms that tend to monopolize. Governments will have to offset these effects by providing social and merit goods through budgetary means.

Wagner’s law, which states an existing relationship between the growth of an industrializing economy and the simultaneous faster growth of the public sector and the government, was the first theory empirically tested. It is of fundamental importance and represents the basis for many government growth theories. However, several critiques and comments on this theory have been expressed in the past:

CRITICISMS

Firstly, due to the fact that the theory was developed in Germany at the end of the 19th century, it only is applicable in economies similar to Germany where rising income was observed as a result of industrialization. The underlying conditions such as rising per capita income, technological and institutional change and democratization therefore limit the possibility of testing the law empirically. Besides, the German origin of this theory and the resulting limited access for non-German speaking economists often contrib­uted to misunderstandings and difficulties for scientists applying this law.

Secondly, instead of providing a positive theory, the law only includes Wagner’s own subjective and normative assumptions: Wagner reveals his opinion on what ought to happen to an economy when it is industrialized. Consequently, although Wagner claims his law being a positive theory, he implicitly employs a normative approach using simple statements which weakens the arguments of his theory if analyzed critically.

A third fundamental critique is the fact that Wagner did not include the impact of wars on public expenditure. This lack of war related expenses can be excused due to the fact that Wagner developed this theory at the end of the 19th century under the optimistic assumption that fewer wars would occur in the future which unfortunately was not the case during the following 20th century.

Furthermore, the organic, self-determining view of the state, which is not the dominating theory in most Western nations has been criticized a lot. According to Wagner, the state represents a superior individual who makes decisions without paying attention to the individual human beings that actually form the state. Wagner thus completely ignores the relationship between individual preferences and government actions which is a strong simplification and thus a major shortcoming of his theory.

Despite these shortcomings, Wagner’s law could be observed and proven in many economies. It is of fundamental importance and many theories are based on this approach.

This theory has gained significant importance so as several empirical researches is being performed on the Wagner’s law.

* Peacock and Wiseman Theory of public expenditure

In 1961, Peacock and Wiseman elicited salient shaft of light about the nature of increase in public expenditure based on their study of public expenditure in England. Peacock and Wiseman (1967) suggested that the growth in public expenditure does not occur in the same way that Wagner theorized. Peacock and Wiseman choose the political propositions instead of the organic state where it is deemed that government like to spend money, people do not like increasing taxation and the population voting for ever-increasing social services.

There may be divergence of ideas about desirable public spending and limits of taxation but these can be narrowed by large scale disturbances, such as major wars. According to Peacock and Wiseman, these disturbances will cause displacement effect, shifting public revenue and public expenditure to new levels. Government will fall short of revenue and there will be an upward revision of taxation. Initially, citizens will engender displeasure but later on, will accept the verdict in times of crisis. There will be a new level of “tax tolerance”. Individuals will now accept new taxation levels, previously thought to be intolerable. Furthermore, the public expect the state to heal up the economy and adjust to the new social ideas, or otherwise, there will be the inspection effect.

Peacock and Wiseman viewed the period of displacement as reducing barriers that protect local autonomy and increasing the concentration power over public expenditure to the Central government. During the process of public expenditure centralization, the role of state activities tends to grew larger and larger. This can be referred to the concentration process of increasing public sector activities.

* Musgrave and Rostow model-

This experiment was performed by 2 different individuals on public expenditure. Musgrave was an economist and Rostow was an economic historian. They believed that the growth of public expenditure is hinged on developmental stages

\* Early development stage.

\* Rapid economic growth.

\* High income stage.

Based on Wagner’s theory, Musgrave also observes the changing role of the public sector during the development process and therefore relies on structural factors in order to explain government growth. According to Musgrave, economies situated in an early development stage are faced with a high demand of public capital formation in order to install a basic infrastructure etc. At later development phases, institutions for private capital formation become more developed and therefore the share of public expenditure may decrease. Despite the fact that this theory is quite plausible, it has one strong limitation which Musgrave admits himself.

While the stages of development approach are indubitably applicable in early development phases, the size of public expenditure cannot be clearly predicted in later stages. It need not always be the case that the share of the public sector further decreases during later stages. Due to the fact of changing private consumption patterns because of rising per capita income during the late industrialization stages, it is possible that the public share rises again in order to meet the growing demand of public goods such as education, infrastructure, social security, health systems etc. It thus depends on the stage of income and on the individual needs of the citizens if the public share rises or decline. Hence, Musgrave remains ambivalent concerning which tendency of public expenditure will dominate at late development stages.

Furthermore, it is also often impossible to define one single stage of development for a particular economy. Especially in developing countries, several stages can be observed simultaneously: Whereas in urban centers the economy might be placed in a later stage of development, rural areas are still often far behind and are situated in early stages. Thus, one cannot predict or derive the development of the public share due to the variety of several stages within one economy.

THE THEORIES OF PUBLIC EXPENDITURE AND NIGERIA.

According to Bhatia (2006), public expenditure refers to the expenses incurred by the government for its own maintenance, maintaining its component units, the general society, the political system and the general economy. This defined the scope of government spending and involvement. Various government engagements in the economy involve some form of expenditures. As supported by some studies, Wagner’s proposition is of the view that public expenditure resulting from increasing state activities increases at an increasing rate as income increases. Contrary to this view is the view held by that government activities should diminish as the economy becomes private-sector driven. This is apparent as many governments of nations of the world are shrinking their participation in means of production and calling for private sector to undertake production and also assist the government via social responsibility role to provide some social amenities.

Wagner (1883) observed that there exists a relationship between economic growth and public spending. He asserted that the growth in public expenditure is a natural consequence of economic growth. That is, the percentage share of public expenditure increases with an increase in gross domestic product. According to Aladejare (2013), Wagnerian and Rostow- Musgrave hypothesis was found to be applicable to the relationship between the fiscal variables used in his study in Nigeria. Contrary to the findings of prior studies of weak support for Wagner’s law for developing countries, Akitobi, Clements, Gupta and Inchauste (2006) found a long-term relationship between government spending and output in developing countries consistent with Wagner’s Law. Verma and Arora (2010) also supported Wagner’s Law only for the long run but refute the existence of any relationship between the economic growth and the size of the government expenditure in the short run.

The results of a study by Ogbonna (2012) in Nigeria supported Wagner’s proposition, Dada and Adewale (2013) affirm that Wagner’s Law is only true for the long run. Peacock-Wiseman Theory (also known as Displacement Theory) argued that the growth of public expenditure follows political economic path. They (Allan T. Peacock and Jack Wiseman) argued that public expenditure does not increase in a smooth and continuous manner, but in jerks and steps like fashion. The occurrence of unexpected social disturbances would necessitate an increase in government expenditures but the inadequacies of revenue position compared with the desired expenditure would cause the government to find a solution to the revenue shortage and also motivate the tax payer to attain a new level of tax tolerance. This displacement from previous tax level is known as the displacement effect. Also, the government has a tendency to take larger proportion of national economic activities resulting from unexpected occurrences, a phenomenon known as the concentration effect.

The process of Wagner’s law is clarified from a demand perception, explicitly; public spending is responsive to the expansionary demand for more public goods, and state regulatory and protective activity. However, there is a budget constraint that the state must observe. The state cannot and does not behave like an unconstrained economic agent but rather it must maximize some form of welfare function subject to a budget constraint. It is plausible at the same time to associate a relationship between government revenue and national income, so that as economic activity heightens or as a country becomes wealthier, tax revenues should rise as well. Rising revenues increase the government's ability to spend. The term government expenditure is defined as a spending on assets. It is the purchase of items that will last and be used time and time again in the provision of goods or services. IMF (2010) states that government expenditure is always focused on public goods such as building of a new hospital purchase of new computer equipment or networks and constructing new roads, among other objectives.

Also, CBN (2011) states that government expenditure is the money spent on goods that are classified as investment goods. This means spending on things that last for a period of time and include investment in hospitals, schools, power sector, telecommunication, agriculture, and road construction. The rising unemployment rate in Nigeria has been a growing concern, despite the fact that the government had embarked on several policies aimed at improving the growth of the economy through the increase in public expenditure. The pattern of government expenditure in Nigeria has been on consistent increase over the years. National Bureau of Statistics (2014) reveals that the rate of poverty in Nigeria has been rising due to factors such as; increased number of school graduates with no matching job opportunities; a freeze on employment in many public and private sector institutions; and mismanagement of capital budget by the government. Thus, given the persistent level of economic growth in the country, remedial measures such as improving fiscal measures in government finances and implementing appropriate actions to attract foreign direct investment among others are considered imperative towards stemming the surge.

The purpose of this study is to determine the validity or otherwise of Wagner’s law and Musgrave and Rostow model in Nigeria by evaluating the causal relationship between the expenditures of government and national income. In the past, government increasing resources influenced greatly the direction of public spending, especially during the oil boom period. However, with the attendant global recession and subsequent fall in government revenue sources mainly from sales of crude oil, there have been mounting pressures on how to effectively utilize scarce government resource to attain significant economic progress in the economy. This scenario has brought back into the public finance discourse the issue of correlation between national income and public expenditure in an attempt to find appropriate policy prescriptions in the management of fiscal policy. It is the opinion of the authors that the outcome of this study will improve fiscal policy administration in Nigeria. The table and graph below depict the relationship between government spending and national income (RGDP) in Nigeria, at a five (5) year interval from 1980 – 2015.

Table 1: Trends in Government expenditure and National income in Nigeria

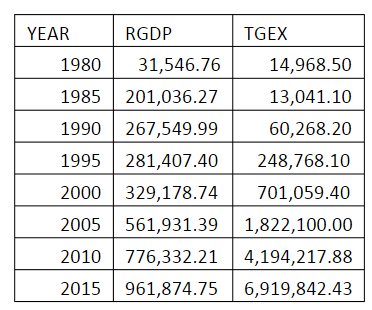




Figure 1

From the above table and graph, it can be seen that government expenditure has not moved in proportion to economic growth. This trend runs contrary to Wagner’s hypothesis.

1. CORRUPTION IN NIGERIA IS ENDEMIC: CHALLENGES AND SOLUTIONS.

Corruption is a global phenomenon, intelligible only in its social context. It can he defined as anti‐social behavior conferring improper benefits contrary to legal and moral norms, and which undermines the authorities’ capacity to secure the welfare of all citizens. In Nigeria it became the principal means of private accumulation during the decolonization period, in the absence of other means, and came to shape political activity and competition after independence.

All subsequent regimes, military and civilian, have been pervaded by corruption. Aided and enhanced by oil revenues, this has created a deepening crisis of kleptocracy, shown in is most extreme form since 1984. It results in a combination of scandalous wealth among the ruling class with growing poverty, misery and degradation among the mass of Nigerians. Political life has become dominated by winner‐take‐all factional struggles, political cynicism and violence, while the economy and social institutions have been driven into decay.

Corruption has thus become a way of life in Nigeria, one which existing governments neither wish to, nor can, control. Combating corruption requires a popular participatory democracy able to monitor and hold to account those in charge of the state and the treasury.

There are varieties of corruption as they manifest in Nigeria, these include: political,

bureaucratic, private, public, materialistic and non-materialistic corruption, petty

corruption and grand corruption, systemic and non-systemic corruption etc.

In a report, Nigeria took the 143rd place to stand as the 39th most corrupt country among the nations of the world. In 2012, the TI also ranked Nigeria as the 35th most corrupt nation in the world. Thus, according to the report, Nigeria scored 27 percent and placed 139th out of about 174 countries surveyed worldwide.

CAUSES OF CORRUPTION.

The general framework for analyzing the causes of corruption can be discerned from

three levels; International, National and Individual levels

a. International Level- the competitiveness of the International markets gives multinational companies an incentive to offer bribes to gain an advantage over other competitors in the system. The Siemens scandal, the National Identity Card saga and Halliburton case are some of the corruption cases involving international companies in Nigeria.

b. National Level- the development strategy of the government may increase

opportunities and incentives for corruption. Three types of relationships exist at

this level; that is, the relationship between the government (elected and appointed

officials) and the civil service; between government and the judiciary and,

between government and the civil society/private organization or individuals.

What comes to mind here is, connivance and privileges. This could be when

awarding contracts or giving concessions for economic reasons or granting of

rights (such as privatization of government owned businesses).

c. Individual Level - This deal with business regulation, management of foreign

aids, outright diversion of public resources, collection of mobilization fees

without execution of the project or abandonment of projects when the amount for

the project has been paid or poor execution of the project, a culture of affluent and

get rich syndrome, unbridled competition between and among different classes of

individual and the tendency to acquire more so as to gain advantage and retain

one's position or aspire for a higher position. This explains why politicians spend

a lot of money during elections period.

Many reasons could be adduced for the endemic nature of corruption in Nigeria. Some of

the factors responsible for corruption in Nigeria are;

i. Weak institution of government, a culture of affluent and get rich syndrome

which has become part and parcel of public officials coupled with the extended

family pressure, village and ethnic loyalties and, unbridled competition between

and among the ethnic groups and a dysfunctional legal system.

ii. Lukewarm attitude of the enforcers of the law (police, judges etc.) forced some

officials to be corrupt because they believe they could go unpunished and get

away with their unwholesome acts. Those in this group are called the sacred

cows, the untouchable, the cabals etc. It goes with varied appellations.

iii. Some cultural and institutional factors could lead to corruption. For example,

nepotism and strength of family values/ties are linked to the feeling of obligation.

Corruption is at times caused by motivational behavior which is a response to social pressures but which violate the set goals and objectives of a social system. In Nigeria for instance, individual rights are often subordinated to groups‟ interests and allegiance to ethnic interests is considered more important than public accountability or national interest. Consequently, individuals who became successful in the public sector are expected to share benefits with selected few (their accomplices and associates).

iv. Sometimes, poor reward system, low remuneration for public servants and greed

account for corruption related behavior or actions. The reward system in Nigeria

is, perhaps, the poorest in the world. Some states in the federation owed workers

between two-six month salaries as at June, 2015. Yet, these members of the

society are expected to be honest, productive and train their children in a most honorable manner without getting their salaries. Corrupt acts become the

alternative means to achieve their objectives and make ends meet because they

cannot depend solely on their meager salaries for a decent living.

v. Some people, individuals or firms engage in Corruption usually occasioned by

bureaucratic bottlenecks. For example, businesses are likely to pay ransom or

spend money in order to facilitate faster processing of their applications or

documents. Individuals frisked at police check points in Nigeria are likely to pay

bribe in order to avoid wasting their precious time. Similarly, individuals who

apply for passports or driver’s license in Nigeria are likely to pay bribe to speed

up the issuing process. Sometimes, the process takes several months. The

money paid serves as a means of avoiding the cost of delay.

vi. Where there exists a principal-agent rent seeking relationship between bureaucrats

and their superiors, especially where such relationship can provoke contests for positions that entitle them to appropriate transfers. In addition, the absence of transparent financial institutions in an economy can serve as an impetus corruption related behavior or transactions or activities. In the 1980s, the discredited Bank of Credit and Commerce International (BCCI) served as the conduit pipe for many Nigerian officials to launder money derived from corrupt transactions into overseas banks.

THE CHALLENGES AND EFFECTS OF CORRUPTION IN NIGERIA.

1. Corruption has led to social conflict and violence as competing groups vie for state power which is the source of distribution of resources and other amenities in the country. This, in economic parlance, retards economic growth. The misappropriation and mismanagement of public resources by successive regimes, has rendered millions of Nigerians poor, unemployed and uneducated. This can be described as oil that worsens factors related to overall human development. It is an anti-social behavior conferring improper benefits contrary to legal and moral norms, and which undermine the authorities to improve the living conditions of the people
2. Corruption also diverts public expenditure from sectors that benefit the poor the most, away to the sectors and project where kick-backs can readily be obtained by public officials. In effect, distorted priorities of public policies and diversion of public resources which could have been productively employed to increase productivity bring about effectiveness and efficiency of government performance becomes the order of the day. This also endangers the fiscal viability of the state as substantial portions of government revenues do not reach government coffers. Because the system creates avenue for leakages. Corruption, as it is averred, can bring about skewing of the composition of public expenditure from social services that are important to the poor.
3. Corruptions can also cause reduction in quality of goods and services available to the public, as some companies could cut corners thereby producing sub-standard goods to increase profit margins. Put differently, it generates allocative inefficiency by permitting the least efficient contractor or most costly supplier with the highest ability to bribe those who award government contracts or awarding contracts to cronies or companies where they have interest. Cumulatively, these acts undermine the reputation of government agencies and also makes them less effective and less efficient and impact negatively on the wellbeing of the people.
4. Corruption also impacts negatively on efficient mobilization and management of human and material resources. It can also alienate modern oriented civil servants and cause them to reduce or withdraw their service and to leave the country for greener pasture as many Nigerians believe it is profitable to work outside Nigeria’s shore.
5. Corruption is a cause of low investment with a resultant effect of reduced economic growth both at foreign and at the domestic level. An economy undermined by corruption has the effect of discouraging foreign investment and public donors. The resultant effect of this is; shortage of fund for productive investment. Simply put, corruption hinders direct foreign investment.
6. Corruption has a negative impact on human rights of the citizens. A country with a corrupt government will have no regard for people’s fundamental human rights as guaranteed in the constitution. Hence, it desecrates the rule of law and distorts the entire decision-making process, undermines the credibility and legitimacy of government. Even, those who tried to expose corrupt activities find themselves to blame as they can be dealt with and the culprits walk away without being punished. This has encouraged the acceptance of the saying “join them if you cannot beat them”

SOLUTIONS TO CORRUPTION IN NIGERIA.

The following recommendations are some of the probable solutions to corruption:

* Introducing or launching national reorientation programs to educate people on

the negative impacts and the need to eradicate corruption in all facets of

Nigerian's public life. MAMSER, National Orientation Agency, War Against

Indiscipline, War Against Indiscipline and Corruption are some of the steps,

programs, agencies and measures taken to tackle corruption. Why these efforts

did not yield fruit or failed to achieve the desired outcome in the past is that the

leaders who introduced these programs distance themselves from its tenets and

doctrines. Leadership, as the dictum says, has to be by example and as such the

doctrines of such programs must be enforced right from the top to the bottom.

The conclusion that these efforts failed because there was no political will to

checkmate, control and eliminate corruption in Nigeria’s public life is absolutely

true

* Moral Regeneration: This involves value re-orientation which de-emphasize the

use of money or wealth for recognition and relevance and, political contests. The

influence of money as a factor in politics must be curtailed and discouraged,

People should be encouraged to vote for people’s qualities rather than money.

Religious leaders‟ consistency and vigor in their campaign against corruption

must be intensified, encouraged and promoted. The indispensability of the role of

the agents of socialization, in this regard, should not be underplayed. This is

because they are the vehicle for mobilization of potential human resources and

agent of change of behavior and value re-orientation.

* The government must introduce an equitable wages and incentive system and

improve other conditions of work so that the level of poverty could be reduced

and the quality of life improved. This will inevitably reduce civil servants'

vulnerability and susceptibility to corruption. This must go hand in hand with

prompt payment of the workers monthly wages and salaries.

* Prosecution of erring individuals or people found to be involved in any corrupt

practice and if found culpable should be punished. This goes with forfeiture of

assets and property acquired illegally. If deemed expedient by the court, anybody

convicted must be also be given long term imprisonment. This will serve as

deterrent to others. This requires strengthening and tightening of prosecution

techniques. Since corruption is a relationship of „give and take‟ both the giver and

the receiver must be prosecuted. No one receives bribes, if nobody offers it. e.

* Government should go beyond the mere pronouncement of anti-corruption

policies. It should rather provide good governance and an enabling environment

for democratic ideals to thrive.

* Societal efforts must be geared towards the abolition of the “winner takes all

syndrome” as this is what makes political contests a matter of life and death.

* The people should be given the right sense of values which should be inculcated

in the people so that they could respect others for their honesty and not just for

their wealth. This will help to develop a positive social attitude and enforcing a

code of public ethics. This could lead to strengthening and checking abuses of

power and privileges.

* Strengthening the police in the war against corruption should include training and

retraining of management and staff officers in fraud and other financial crimes

investigation and forensic accounting, adequate remuneration and motivation. The

investigation process should go in tandem with current realities as its methods

must be capable of tracking, discover, expose and prove beyond reasonable doubt

any corrupt allegations.

* Anti-corruption body and transparent monitoring unit should be established in all

public institutions, empowered and made functional in such a way as to detect and

report corrupt officials for prosecution.

* Strengthening the constitutional institutions set up to fight corruption e.g. Code of

Conduct Bureau, Code of Conduct Tribunal, Public Complaints Commission.

This may require amendment of the enabling acts and make their existence

relevant and proactive and, operations effective, efficient and result oriented.

With this, their existence and public resources expended on them could be

justified.

* Increase awareness on the economic, political, social and legal cost of corruption

and corrupt practices on individual and the society at large. Campaigns of

honesty, probity and accountability must be intensified, encouraged, promoted

and institutionalized.

* An open system of government is linked to accountability and has

come with the name “Freedom of Information Act”, where there is a

constitutional and legal structure for disclosure and to make available all official

documents when it is demanded for or required. This platform enables the

existence of a free media and open avenues to investigate and expose corrupt

practice at whatever level and no matter the status of who is or those involved.

* Above all, the country needs committed leadership, a re-oriented public service, a

vibrant judiciary and an organized and vocal civil society. There must be a

synergy between and amongst these structures of the state. The need for

collaboration requires that institutions, departments, groups, and individuals

whose activities border on fight against corruption work closely together. This

calls for a complex web of interrelated institutional remedies. The collaboration is

essential if the ravage, destruction of life and property caused by corruption are to

be brought under control.

In a nutshell, in order to fight corruption all members of the Nigerian society have the responsibility to educate, mobilize, enlighten and sensitizing it members towards a tradition of honesty, excellence, truth, reputation, good name and other moral virtues that would Nigeria a better place for all. Conclusively, it is noteworthy to acknowledge that it is impossible to eliminate corruption entirely but its magnitude and cases can be minimized or reduced. This stage is referred to as negligible or tolerable corruption level.

**QUESTION 2**

1. GOVERNMENT FAILURE.

Government failure, in the context of public economics, is an economic inefficiency caused by a government intervention, if the inefficiency would not exist in a true free market. It can be viewed in contrast to a market failure, which is an economic inefficiency that results from the free market itself, and can potentially be corrected through government regulation. The idea of government failure is associated with the policy argument that, even if particular markets may not meet the standard conditions of perfect competition required to ensure social optimality, government intervention may make matters worse rather than better.

Government failure does not occur when government action creates winners and losers, making some people better off and others worse off than they would be without governmental regulation. It occurs only when governmental action creates an inefficient outcome, where efficiency would otherwise exist. A defining feature of government failure is where it would be possible for everyone to be better off (Paretto Optimality) under a different regulatory environment.

Sometimes, when the government intervenes it can turn out to be ineffective, misplaced and inequitable.

CAUSES OF GOVERNMENT FAILURE.

1. Imperfect information

Imperfect information may be a source of not only the market failure, but also of the government one. Even the state cannot be provided with all the information, which is necessary to reach the equilibrium and stability within the market.

1. Human factor

People working inside the governments are also ordinary humans. It is usual for humans to strive to reach personal interests and maximize welfare. Thus, if a person places own interests above common interests, decisions taken by such person can degrade public welfare.

1. Influence of interest or pressure groups

Not uncommon is also the impact of people or even groups of people, who are able to manipulate politicians inside a government in order to reach their common goals. These groups usually have a powerful influence. It is difficult for the society to confront them because these groups act in a coherent way due to restricted number of members and shared objective in contrast to the rest of the society.

1. Political self-interest

When politicians and civil servants seek to pursuit self-interest, it can lead to incorrect allocation of resources. The pressures of the upcoming elections or the influence of interest groups can support an environment in which inappropriate spending and tax decisions can be made. - e.g. increasing social expenditure before the elections or presenting the main capital expenditure items for infrastructure projects without the projects being subjected to a full and proper cost-benefit analysis to determine the likely social costs and benefits.

1. Policy myopia

Another cause of the government failure, as many critics of government intervention claim, is that politicians tend to look for short term fixes with instant and visible results that do not have to last, to difficult economic problems rather than making thorough analysis for solving long term solutions.

1. Regulatory Capture

This happens when the industries under the control of a regulatory agency act to secure commercial or political interests of producers rather than consumers. Which can cause a risk that reduces the quality of life of those consumers. Regulatory capture can happen due to various reasons such as corruption, bribery, etc., mostly when regulators come to the realization of getting some kind of profit from the industry they are regulating. In general, it is expected that the regulatory agency and its industry should have some professional relationships. However, how to spot that it already crossed the line? When the relationship becomes too smooth, close with de-fusing principles, that can be the first incentive of regulatory capture.

EXAMPLES OF GOVERNMENT FAILURE.

1. Distortion of the price mechanism

Intervention through taxation, through subsidization, or via other interventions can result in a distortion of markets and a weakening of the operation of the price mechanism. Taxes and subsidies on goods and services can artificially raise or lower prices and distort how markets work to allocate scarce resources.

Direct taxation can create a disincentive effect for households and firms. We have seen that taxes on harmful demerit goods, where demand is inelastic, may simply mean that more income is allocated to expenditure on harmful goods, and hence less income is available for spending on beneficial goods.

The same is possible with the imposition of a minimum price, such as the one on alcohol, where spending is distorted with the consumer allocating more income to alcohol rather than less.

Subsidies can be criticized as they can encourage the wasteful misuse or over-use of scarce resources. For example, free healthcare can result in doctors’ waiting rooms becoming become full with the malingerers and the so-called ‘worried well’. This can result in a waste of public resources and a denial of access to these services by those in genuine need. Subsidies may also protect inefficient firms from open competition as well as creating artificial barriers to entry for new firms – given that prices are kept ‘artificially’ low. Subsidies, and other assistance, can lead to the wider problem of moral hazard.

1. Costs of administration

Excessive bureaucracy is also a potential government failure. This is caused by the public sector when it tries to solve the principal-agent problem. Government must appoint bureaucrats to ensure that its objectives are pursued by the managers of public sector organizations, such as the NHIS.

Intervention through the imposition of taxes, or through legislation incurs various administration costs. Taxes must be collected through government departments, and laws must be enforced through the legal system. Both of these incur considerable costs.

1. Imperfect knowledge

Information failure is also an issue for governments, given that government and policy makers do not necessarily ‘know’ enough to enable them to make effective decisions about the best way to allocate scarce resources.

Government intervention requires decisions to be made about the degree of intervention and its timing. In order to prevent or reduce market failures, tax rates need to be set and level of subsidies and minimum prices must be decided. However, governments and agencies do not have access to all the knowledge that it required to set the necessary rate or level to achieve the desired outcome. For example, if the government wishes to get 3 million students to attend university each year it may decide to subsidize tuition fees, but it is highly unlikely that it could achieve such a target with precision.

Many economists believe in the efficient market hypothesis, which assumes that the market will always contain more information than any individual or government. The implication is that market prices and market movements should be free from interference because markets cannot be improved upon by individuals or governments.

Critics of intervention and supporters of free markets argue that it is impossible for a group of planners to have as much knowledge as is contained within a free market, and that government intervention almost inevitably is less efficient as compared with allowed resources to be allocated through freely interacting market forces.

1. Law of unintended consequences

Finally, and related to the idea of information gaps, is idea that intervention can result in outcomes which were entirely unplanned and unpredicted. Traffic calming measures may encourage drivers to speed up in areas or stretches of roads between speed bumps, cameras or warning signs – with a result that ‘average’ speeds increase. This resulted in new systems which track average speeds. However, in an average speed area driver may drive a below the speed limit so that they can speed up along other parts of the journey.

When assessing any intervention in the micro or macroeconomy government failures are a common source of evaluation points.

1. EFFECTS OF COVID-19 ON THE NIGERIAN ECONOMY AND ARE YOU IN SUPPORT OF THE ACTIONS TAKEN BY THE GOVERNMENT?

Yes, I am in support of these actions

In December 2019, a cluster of pneumonia cases from an unknown virus surfaced in Wuhan, China. Based on initial laboratory findings, the disease named Coronavirus disease 2019 (abbreviated as COVID-19), was described as an infectious disease that is caused by severe acute respiratory syndrome coronavirus 2. The COVID-19 outbreak has since spread to about 196 countries and territories in every continent and one international conveyance across the globe. While there are ongoing efforts to curtail the spread of infection which is almost entirely driven by human-to-human transmission, it has accounted for over 400,000 confirmed cases with over 18,000 deaths.

With 2.4 million coronavirus cases and 163,143 deaths globally, the world continues to battle the COVID-19 pandemic. Even before the outbreak, the outlook for the world economy and especially developing countries like Nigeria was fragile, as global GDP growth was estimated to be only 2.5 percent in 2020. While many developing countries have recorded relatively fewer cases Nigeria currently has 782 confirmed cases and 25 deaths as of this writing the weak capacity of health care systems in these countries is likely to exacerbate the pandemic and its impact on their economies.

The slowdown in the global economy and lockdown in some countries, such as Nigeria, Italy, Spain and most Eurozone economies and beyond, as a result, COVID-19 has also taken its toll on the global demand for oil. The decline in oil demand is estimated to surpass the loss of nearly 1 million barrels per day during the 2007-08 recession. This is also coming at a time when two key players in the global oil industry Russia and the OPEC cartel are at loggerheads on the decision to cut output. The unequivocal oil price war started between these two global oil market giants may have more dire consequences on the oil price that has started to dive.

AGGREGATE DEMAND WILL FALL, BUT GOVERNMENT EXPENDITURE WILL RISE

In Nigeria, efforts were already being made to bolster aggregate demand through increased government spending and tax cuts for businesses. The public budget increased from 8.83 trillion naira ($24.53 billion) in 2019 to 10.59 trillion naira ($29.42 billion) in 2020, representing 11 percent of the national GDP, while small businesses have been exempted from company income tax, and the tax rate for medium-sized businesses has been revised downwards from 30 to 20 percent. Unfortunately, the COVID-19 crisis is causing all components of aggregate demand, except for government purchases, to fall

HOW THE COVID-19 PANDEMIC AFFECTS THE COMPONENTS OF AGGREGATE DEMAND.

The fall in household consumption in Nigeria will stem from

1) partial or full restrictions on movement, thus causing consumers to spend primarily on essential goods and services.

2) low expectations of future income, particularly by workers in the gig economy that are engaged on a short-term/contract basis, as well as the working poor in the informal economy.

3) the erosion of wealth and expected wealth as a result of the decline in assets such as stocks and home equity.

ACTIONS TAKEN BY THE FEDERAL GOVERNMENT OF NIGERIA.

The decision to close educational institutions and schools around the globe in an attempt to contain the pandemic has also led to a soaring number of children, youth and adults not attending schools. According to UNESCO Monitoring report on COVID-19 educational disruption and response, the impact of school closures in the over 100 countries that have implemented the decisions around the world has impacted over half of the global students’ population. These educational disruptions are being escalated particularly for the most vulnerable members of society.

The federal government has imposed a lockdown in Lagos and Ogun states as well as Abuja (which have the highest number of coronavirus cases combined). Subnational governments have quickly followed suit by imposing lockdowns in their states. Nigeria has a burgeoning gig economy as well as a large informal sector, which contributes 65 percent of its economic output. Movement restrictions have not only reduced the consumption of nonessential commodities in general, but have affected the income-generating capacity of these groups, thus reducing their consumption expenditure.

Investments by firms will be impeded largely due to the uncertainties that come with the pandemic-limited knowledge about the duration of the outbreak, the effectiveness of policy measures, and the reaction of economic agents to these measures—as well as negative investor sentiments, which are causing turbulence in capital markets around the world. Indeed, the crisis has led to a massive decline in stock prices, as the Nigerian Stock Exchange records its worst performance since the 2008 financial crisis, which has eroded the wealth of investors. Taking into consideration the uncertainty that is associated with the pandemic and the negative profit outlook on possible investment projects, firms are likely to hold off on long-term investment decisions.

On the other hand, government purchases will increase as governments, which typically can afford to run budget deficits, utilize fiscal stimulus measures to counteract the fall in consumer spending. However, for governments that are commodity dependent, the fall in the global demand for commodities stemming from the pandemic will significantly increase their fiscal deficits. In Nigeria’s case, the price of Brent crude was just over $26 a barrel on April 2, whereas Nigeria’s budget assumes a price of $57 per barrel and would still have run on a 2.18 trillion-naira ($6.05 billion) deficit. Similarly, with oil accounting for 90 percent of Nigeria’s exports, the decline in the demand for oil and oil prices will adversely affect the volume and value of net exports. Indeed, the steep decline in oil prices associated with the pandemic has necessitated that the Nigerian government cut planned expenditure. In fact, on March 18, the minister of finance announced a 1.5 trillion naira ($4.17 billion) cut in nonessential capital spending. But as at April 20, oil price fell below US$1.

The restrictions on movement of people and border closures foreshadow a decline in exports. Already, countries around the world have closed their borders to nonessential traffic, and global supply chains for exports have been disrupted. Although the exports of countries that devalue their currency due to the fall in the price of commodities (like Nigeria), will become more affordable, the limited markets for nonessential goods and services nullifies the envisaged positive effect on net exports.

WHAT ARE THE POLICY RESPONSES BY THE NIGERIAN GOVERNMENT?

Already, the Central Bank of Nigeria (CBN) has arranged a fiscal stimulus package, including a 50 billion naira ($138.89 million) credit facility to households and small and medium enterprises most affected by the pandemic, a 100 billion naira ($277.78 million) loan to the health sector, and a 1 trillion naira ($2.78 billion) to the manufacturing sector. In addition, the interest rates on all CBN interventions have been revised downwards from 9 to 5 percent, and a one-year moratorium on CBN intervention facilities has been introduced, effective March 1.

With oil being Nigeria’s major source of foreign exchange, amid the steep decline in oil prices, the official exchange rate has been adjusted from 306 to 360 naira. The exchange rate under the investors and exporters (I&E) window has also been adjusted from 360 to 380 naira in order to unify the exchange rates across the I&E window, Bureau de Change, and retail and wholesale windows. Furthermore, the government has introduced import duty waivers for pharmaceutical companies and increased efforts toward ensuring that they receive forex.

WHAT OTHER POLICY RESPONSES CAN BE IMPLEMENTED?

Given the size and scope of the economic impact of the pandemic, there is the need to implement other recovery strategies to stimulate demand. Thus, we recommend the following fiscal and monetary policy measures:

Although there is a cash transfer program in place, the federal government should improve efforts towards enhancing the efficiency and effectiveness of the distributive mechanisms to reach households that are worst-hit by the pandemic.

The Federal Inland Revenue Service (FIRS) as well as State Inland Revenue Services (SIRS) should waive payments on personal and corporate income tax for the second quarter of 2020, considering that the shock has affected the income and profits of households and businesses.

The CBN’s decision to increase the cash reserve ratio (CRR) from 22.5 percent to 27.5 percent in January 2020 should be revisited to provide liquidity for banks so that banks can, in turn, create credit to the private sector.

FIRS and SIRS should delay tax collection for the worse-hit sectors including tourism, the airline industry, and hoteliers in order to enable them recover from the steep decline in demand.

To provide additional liquidity in the forex market, the CBN should establish a swap facility with the U.S. Federal Reserve and/or the People’s Bank of China, as was done in 2018, to provide dollar and yen liquidity to financial institutions, investors, and exporters. This move would ease up forex shortage in the financial market and economy.

While the naira has been adjusted as a result of the forex shortage, it is important that the CBN maintains exchange rate stability by deploying external reserves in order to avoid investors selling off naira-denominated assets.

The COVID-19 pandemic is a wake-up call to policymakers as the unusual and unprecedented nature of the crisis has made it impossible for citizens to rely on foreign health care services and more difficult to solicit for international support given the competing demand for medical supplies and equipment. A more integrated response spanning several sectors—including the health, finance, and trade sectors—is required to address structural issues that make the country less resilient to shocks and limit its range of policy responses. In the long term, tougher decisions need to be made, including but not limited to diversifying the country’s revenue base away from oil exports and improving investments in the health care sector in ensuring that the economy is able to recover quickly from difficult conditions in the future.