**INFLATION IN NIGERIA: POSSIBLE**

**DETERMINANTS AND REMEDIES TO TACKLE IT IN NIGERIA**

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Abstract

The previous Governor of the Central Bank of Nigeria (CBN) had intended to introduce the N5,000.00 currency bill into the Nigerian economy and claimed that such currency bill would help it manage the exchange rate especially against the dollar. This generated a huge outcry from the public especially economists. The major reason was that this introduction would generate inflation and also because the policy ran counter to the cash-less policy of the Central Bank of Nigeria. But to the Central Bank, there was no economic theory to suggest a currency redenomination could cause inflation. This debate once more threw up a need to reexamine the determinants of inflation in Nigeria. Generally, inflation could be cost push or demand pull but what drives the demand or informs cost quite often differ from one economy to another. This study examined the factors responsible for increasing cost of production and spending behaviour in Nigeria. It was able to identify 13 factors that impact on inflation. However, the degree of impact of each factor is left for another study. The study recommends that government should concentrate on providing social infrastructure that would encourage the private sector to invest and expand output, taking advantage of existing unemployed resources. This would help to stem inflation in Nigeria which is usually caused by scarcity.

Keywords:Inflation, Cost Push, Demand Pull, Determinants

1. BACKGROUND

Nigeria is often referred to as the Giant of Africa, it is the 7th largest populated country in the world with about 167 million people; one out of every 4 persons in West Africa is a Nigerian and Nigeria is the largest country entirely of Negroes. Apart from its abundance of human resources, the country is blessed with large arable lands and mineral resources. These resources include, coal, tin ore, crude oil and gas among others. But it is an underdeveloped economy characterized by high unemployment rate, inflation, poverty, low capacity utilization among many other such factors.

* 1. The Challenge

Inspite of these challenges, the Central Bank of Nigeria in recent times have consistently churned out harsh policies that the bank claims are aimed at cushioning inflation in Nigeria. For instance, on Tuesday, 25th January 2011, the Central Bank increased the Monetary Policy Rate (MPR) by 25 basis points from 6.25 to 6.5 percent to reduce money supply in the economy (See Otto and Nembee, 2011). Between January 2011 to January 2013, the MPR has been increased to 12.5 percent. These increases impact on the prime lending rates of banks, thus affect cost of borrowing and ultimately the cost of production of goods or services in the country. This in turn is likely to impact on total investments output, employment and development. In addition, in 2012, the Central Bank set out to issue N5,000 bill which was publicly resisted because to many such currency denomination was likely to create inflation, more so, because lower currencies of ~~N~~1, ~~N~~5, ~~N~~10 and ~~N~~50 were to be coined. The Central Bank authorities argued that there were no theoretical basis for such claims. So where do we stand? Is redenomination a determinant of inflation in Nigeria?

* 1. The Objective

Against the aforesaid background, this paper set out to identify factors that drive inflation in Nigeria. The paper used both primary and secondary sources to generate its data. First, literature survey was done. Thereafter a cross sectional survey was carried out among 100 professionals and experts from different parts of the country to identify factors affecting inflation in Nigeria.

* 1. Conceptual Issues

Inflation defines a rise in the general level of prices of goods and services in an economy over a period of time. Inflation may also be defined as a sustained rise in general price levels or a period of persistent rise in prices. The implication is that each unit of the currency in question will buy less than it had previously bought. Inflation could bring about the debasement of the means of exchange.

Historically, infusions of gold or sliver into an economy lead to inflation. According to http//wiki.org./inflation.com (2012), culled on 25th May, 2012, when gold was used as currency, government could collect gold coins melt them down, mix them with other metals such as silver, copper etc and reissue them at the same nominal value. By diluting gold with other metals government could issue more coins without needing to increase the amount of gold used to make them. When the cost of each coin is lowered in this way, government profits from an increased seigniorage. This practice increases the money supply but at the same time the relative value of each is lowered. As the relative value of the coin is lowered, consumers would need to give more coins in exchange for the same goods and services as before. These goods and services experience a price rise as the value of each coin is reduced.

Inflation could be creeping, galloping or hyper. Increases in the quantity of money had occurred in different societies at different times in history.

1. THEORIES OF INFLATION

Several theories have been posited to explain inflation world wide. They include: Demand – pull inflation; Cost – push inflation; Structural inflation;

Imported inflation

* 1. The Demand Pull Theories of Inflation

Demand-pull theories of inflation define inflation situations where aggregate demand for goods and services exceed aggregate supply, thereby leading to a general rise in price levels. Usually the shortages create competition on the side of demand for the few available products leading to some kind of informal bidding for available items. The aggregate demand for these goods and services include the private demand for consumers’ goods, business firms and government including final output and inputs.

The demand–pull inflation may also be called surplus demand inflation because it arises from too much money chasing few goods. More often it occurs where there is full employment so that the excess pressure on the factors of production leads to higher prices for the factors, ultimately leading to rise in the cost of production. It could also be a short run phenomenon where demand dynamics were not well anticipated. When there are production constraints, demand beyond the possible output level could also create inflation.

Demand- pull inflation may occur during cyclical booms during or immediately after war, This explains its high rates in Nigeria between 1969 – 1970. The rate of inflation during the war was very high and could have been as high as 20 percent or more. In the Biafran enclave, inflation was in three digits. These may not have been officially reported in their exact forms. In other words, inflation rates in Nigeria are generally believed to be under reported.

The demand pull inflation may be explained using the old or new quantity theory of money or the Keynesian theory. The quantity theory of money attempts to explain the link between money and general price levels. The quantity theory (also referred as monetarists view) emphasize the influence of money supply as prime determinants of inflation while the Keynesians emphasize on non monetary factors such as government expenditure, spending pattern and credits. The classical economist of the 17th Century connected the quantity theory of money to the general rise in prices. The crude quantity theory of money (of classical economy) state that the quantity of money at any given point in time is proportional to rise in prices.

The monetarist school of thought led by Milton Friedman (1942) posits that inflation is ‘always and everywhere a monetary phenomenon and that it is everywhere since increases in the quantity of money always exceeds output’. Irving Fisher’s equation of exchange could be employed to explain the

Monetarist view. Fisher (1913) starts the analysis with a single identity that MV=PT. Fisher believes that in every transaction, there is a buyer and seller in the aggregate economy, the value of sales must be equal to the value of receipts. This identity can be mathematically modeled as follows:

MV = PT (1)

Where M = Quantity of money (nominal) in circulatiom;

V = Transaction velocity of money in final expenditures;

P = General price level;

T = Volume of transactions;

Therefore in reviewing the monetarist view and the concept of circulation, Fisher defines price (P) as a function of money supply (M), volume of

transactions (T) and velocity of circulation (V), i.e

P = F (M,V,T) (2)

In equation (1), where MV = PT, Fisher assumes V and T to be constant variables, so, M varies directly with P.

P = M (3)

But Fisher’s equation is its failed to consider the impact of interest rates. It is also doubtful that M.V.P and T are fully independent as a change in any of them impacts on the others and can affect inflation.

This made Keynes (1940) to focus on the inflationary gap, Keynes explained that *inflationary gap is a process where planned expenditure exceeds the equilibrium in the system*; if there is a state of under-employment in the economy, an increase in the money supply will eventually lead to an increase in aggregate demand, output and employment.

But as aggregate demand, output and employment rise further, it impacts on price. When money supply increases beyond full employment, output ceases to rise. The excess money supply leads to an excess demand over supply and leads to an inflationary gap. This to Keynes is the true source of inflation. Keynes inflationary gap analysis is illustrated graphically in fig. 1.

|  |  |  |
| --- | --- | --- |
| **Figure 1.** Illustration of Keynesians Theory of Demand Pull Inflation                                                      C + I + G    Y    C, I, G    45      B    A    Inflationary Gap    E  1    C    Expenditure (C+I+G)    Income    YEF  1      YE  1      O    *Note: See Onuchuku and Adoghor (2000)*     |  |  | | --- | --- | | Figure 1 shows the points where full  employment (YEF1) equilibrate with the total output. It is being represented by a 45 line which cuts through point B. But if there are further increases in aggregate demand, it will cause a shift in expenditure as shown at point E, and this will make the total expenditure to be at YE1 while the available output is BAYE(See Onuchuku Adoghor 2000). Keynes has been criticized. The major thrust of critics is that the inflationary gap analysis is focused on the commodity market only and the analysis | neglects the role of the factor markets. It is argued that inflation affects both commodity and factor markets because the excess demand caused by the commodity market would have an impact on the factor market. In point, Keynes analysis has two main drawbacks: (a) it lays emphasis on demand (b) it ignores the possibility that a price rise may lead to further increases in aggregate demand, which may in turn lead to further increases in aggregate demand, which may in turn lead to further rise in prices (See Jhinghan 2008). |     **Figure 2.** The Demand Pull Theory of Inflation (Quantity Theory Version) |

Price Level

*Note: See Gbanador (2007)*

Figure 2 shows that if the economy is in full employment, the Equilibrium price P1 cuts the Demand curve Di at A. However, further demand as shown in D2 will raise prices to P2. It means that employment, and aggregate supply cannot be increased at the short run to offset the excess demand created by the shift. This is because output and supply are fixed at 0Y .

Y

P

Y

O

D

1

D

2

A

B

D

2

D

1

P

2

P

1

Output

1

|  |  |  |
| --- | --- | --- |
| |  |  | | --- | --- | | 2.2. Cost – Push Theories of Inflation:    Cost-push defines inflation arising from the supply side. It is often caused by the rising cost of production. This occurs when production costs increase and impact on the prices of the final products. The cost push inflation can also be called the “market power inflation” because the increase in the prices of goods and services originates from the supply side of the economy. These increases may arise from increased wage rates or a fall in productivity which also increases cost of labour output. It may also arise out of other factors of production or cost of inputs such as power supply, transport or raw materials. In Nigeria multiple | taxation and corruption are major suspects. These and other factors cumulatively influence the cost structure of products and determine the prices of the final output. Producers would react to rise in input prices by increasing prices of output including their profits margins, since these are usually set at fixed percentage of cost of production. But an increase in the cost of production can force producers to cut down production.  Cost- push inflation may also arise as a result of profit motives of producers in monopolistic and Oligopolistic industries. Since there exist a state of imperfection in such industries, their producers could administer their prices through price discrimination techniques. |     **Figure 3.** Diagram Depicting the cost – push Inflation |

S

D

1

Y

P

Price Level

Y

N

O

A

X

D

1

P

2

P

1

S

1

2

M

Y

F

Output

*Note: see Gbanador (2007)*

Figure 3 Illustrates inflationary tendencies caused by supply- side factors. Point M. is referred to as the equilibrium point at full employment. At this point, price is P1 and quantity of output is Yf but if the cost of inputs rise (such as increasing wages, rising cost of power supply through removal of fuel subsidy; among others), some suppliers with limited resources could cut production. This will lead to a fall in aggregate output of the particular industry as shown in YN. So, supply moves from S

1 yF to S . This reduction in total supply distorts the

2 YN.

full equilibrium position and causes a bidding among demand (i.e. buyers of the good) for the available goods ultimately shooting up the price from P1 to P2 and a new equilibrium point at x. This explanation makes meaning in a market economy where the market is an allocator of economic resources. But another way to explain the cost-push (supply – side) inflation is to look at the behaviour of suppliers. As a result of increasing cost of production (often not peculiar to any producer), suppliers generally shift the burden of increased cost of production to the consumers by way of general price increases. If all suppliers do so, this is likely to lead to general rise in the prices of products. This is more common in imperfect markets.

In Nigeria, cost-push inflation is quite common. Every time government announces a new minimum wage, there is a rise in the prices of goods and services leading to inflation. This often nullifies the gains of the wage rise, leaving the Nigerian worker sometimes poorer than he or she was before the wage rise though, Otto (2011) attributes this to the announcement effect. Examples include the Udoji award of 1973 and the Shehu Shagari’s salaries and wages review of 1980 respectively. Between 1941 and now there has been about 15 of such wage reviews. These wage increases, often are not matched with increases in productivity and so lead to inflationary situations.

A.W Philips (1958) examined the relationship between unemployment and inflation in Britain. He observed that there was an inverse relationship between unemployment and inflation. This is known as the Philip’s curve. He observed that when unemployment rate is high and the wage rates low, inflation will be low because of insufficient demand.

This is a typical feature of an economy in recession because in such situation output shrinks. This was also the scenario in the world in the 1920s and 1930s before the Second World War. On the other hand, a growing economy with increasing output was more likely to be inflationary. This is because the increase in economic activities will call forth various economic factors. The high demand for these factors of production, drive up the cost of factors of production and the cumulative effect of the rise of input (factor) costs lead to increases in output prices. Because these factors are supplied by households, these households are more economically empowered and this empowerment facilitates their ability to bear the cost of the rising output prices. The upshot of Philips’ finding was that a trade off exists between inflation and unemployment: Both are mutually exclusive. If government opts for full employment, it must tolerate some level of inflation but if does not want inflation at all, it should minimize its growth and full employment objectives.

**Table 1.** Wage Reviews in Nigeria

|  |  |  |
| --- | --- | --- |
|  | ***Commissions*** | ***Year of implementation*** |
| 1 | Bridge Committee | 1941 |
| 2 | Tudor Davis Commission | 1945 |
| 3 | Harapim Commission | 1946 |
| 4 | Miller’s Commission | 1947 |
| 5 | Gorsuch Commission | 1955 |
| 6 | Mbanefo and Morgan’s Commission | 1959 |
| 7 | Morgan’s Commission | 1963 |
| 8 | Adebo’s Commission | 1970 |
| 9 | Udoji’s Commission | 1973 |
| 10 | Shagari Award | 1980 |
| 11 | I.B.B. Wage Review | 1992 |
| 12 | Abdulsalam Wage Review | 1999 |
| 13 | Obasanjo Wage Review | 2001 |
| 14 | Yar’Adua Minimum Wage Review | 2008 |
| 15 | Jonathan Minimum Wage Review | 2011 |

*Source: Various*

Since the era of Philips, the fact of stagflation has diminished the significance of Philips. In many developing economies, inflation and unemployment exist side by side. South American countries especially Brazil exemplified stagflation in the 1970s

and 1960s

2.3. Theories of Structural Inflation

Structural inflation defines inflation that are associated with the process of economic development. This is because the process creates disequilibria through the structural changes which are necessary for development. Theorists believe that inflation is usually associated with economic growth especially in developing countries where institutional and structural constraints are real.

Inflation also has a long-run tendency especially in the industrialized western countries owing mainly to differences in the rates of growth of productivity in the industrial and service sectors. According to Turvey (1951), cited in Jhinghan (2008) inflation arises from the process of competition to maintain total income, total real expenditure and total output. This view is reinforced by Schultz (1959).

Charles Schultz (1959) observed from a study of inflation in United States of America 1955-1957, that price increases were neither caused by demand pull nor cost-push factors but by sectorial shifts in demand. He postulated that since price do not fall in deficient sectors, the excess demand in other sectors will lead to a general price rise in a deficient sector and this will cause an inflationary trend in the economy.

2.4. Imported Inflation

This is a type of inflation suffered by economies with high reliance on imported goods or services. Such inflation could arise from the dumping of goods in the importing economy either as inputs or final output. The high prices of these imported goods are transmitted into the local economy which leads to an inflationary tendency.

A number of channels have been identified through which inflation is transmitted; one of the most efficient anti-inflationary policy in Nigeria would be to increase the domestic supply of goods and services to meet growing demand, if this was possible. But the inelastic demand for foreign goods is a major constraint that must be dealt with. For oil producing countries like Nigeria, inflation could be to controlled if crude oil could be refined in the country in the short run and a restructuring of the economy into a more organized system in the longrun. An efficient management of the exchange rate can minimize imported inflation.

3. INFLATIONARY TRENDS AND EFFECT IN NIGERIA

Table 2 presents some macroeconomic variables in

Nigeria including inflation

**Table 2.** Macroeconomic Variables in Nigeria (1980 – 2010)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| ***Year*** | ***MSO NB*** | ***INT %*** | ***INF %*** | ***MSS NB*** |
| 1980 | 3485.9 | 9.50 | 16.11 | 15100 |
| 1981 | 13847.9 | 10.00 | 17.4 | 16161.7 |
| 1982 | 15633.5 | 11.75 | 6.90 | 18093.6 |
| 1983 | 10797.4 | 11.60 | 38.80 | 20879.1 |
| 1984 | 9532.8 | 13.00 | 22.60 | 23370 |
| 1985 | 12032.4 | 11.75 | 11.00 | 26277.6 |
| 1986 | 11582.6 | 12.00 | 13.70 | 27389.8 |
| 1987 | 12041.6 | 19.20 | 9.70 | 33667.4 |
| 1988 | 13713.9 | 17.60 | 51.20 | 45446.9 |
| 1989 | 14011.5 | 24.60 | 44.70 | 47055 |
| 1990 | 14702.4 | 27.70 | 3.60 | 68662.5 |
| 1991 | 16078.5 | 20.80 | 23.00 | 87499.8 |
| 1992 | 15357.2 | 31.20 | 48.80 | 129085.5 |
| 1993 | 14788.1 | 36.09 | 61.30 | 198479.2 |
| 1994 | 14991.4 | 21.00 | 76.80 | 266944.9 |
| 1995 | 13836.1 | 20.79 | 51.60 | 318753.5 |
| 1996 | 13953.4 | 20.86 | 14.30 | 370333.5 |
| 1997 | 14010 | 23.32 | 10.20 | 429731.3 |
| 1998 | 13046.3 | 21.34 | 11.90 | 525637.8 |
| 1999 | 13494.6 | 27.19 | 20.00 | 699733.7 |
| 2000 | 13958.8 | 21.55 | 14.50 | 1036079.5 |
| 2001 | 14935.1 | 21.34 | 16.50 | 1315869.1 |
| 2002 | 16439.4 | 30.19 | 12.10 | 1599494.6 |
| 2003 | 17369.6 | 22.88 | 23.80 | 1985191.8 |
| 2004 | 19436.8 | 20.82 | 10.00 | 2263587.9 |
| 2005 | 21305.1 | 19.49 | 11.60 | 2814846.1 |
| 2006 | 23305.9 | 18.70 | 8.60 | 4027901.7 |
| 2007 | 25535.5 | 18.36 | 6.60 | 5349253.3 |
| 2008 | 27806.8 | 18.70 | 15.10 | 8518489.2 |
| 2009 | 30013.8 | 22.90 | 12.10 | 10767377.8 |
| 2010 | 32281.31 | 22.51 | 13.80 | 11154782.8 |

*Source: Central Bank of Nigeria Statistical Bulletin (See Cenbank.org)*

*Key: MSS = Money Supply; MSO = Manufacturing*

*Sector Output; INT = Interest Rate; IFL = Inflation Rate*

|  |
| --- |
| **Figure 4.**  Inflation and interest rates in Nigeria (1980  -  2010)          0  10  20  30  40  50  60  70  80  Inflation  Interest Rate  Years    Rate |

*Source: Drawn from Table 2*

Inflation poses serious challenge especially in developing countries (see Dornbusch, 1992) including Nigeria. Inflation increase the cost of goods, deepens poverty and makes life difficult for the poor. Inflation in Nigeria keeps soaring inspite of unemployment, figure 4 shows the relative movement of inflation and interest rates in Nigeria between 1980 and 2010. The specific effects of inflation in Nigeria include:

3.1. Planning Problems

Inflation in Nigeria impacts on planning and financial projections. Inflation makes it difficult to estimate the cost of living or cost of production based on current prices, because sooner or later inflation creates cost overrun which distorts these plans. The instability does not encourage foreign investors into the economy.

3.2. Project Execution

Government Projects are often abandoned on account of inflationary pressures in Nigeria. Projects planned on the basis of current prices may soon run into difficulties because inflation may have doubled the assumed prices. These cost over runs makes it difficult for contractors or project executors to continue such projects. This is a major source of uncompleted projects in Nigeria.

3.3. Discourage Savings

An inflationary economy discourages savings, because the real value of the saved sum is eroded by inflation. Thus, it is not efficient to save monies during inflation but savings are critical for investments. Apart from investments the need to address emergent difficulties are ever present with us. And in an economy where access to funds are difficult, this is a great challenge.

3.4. Inequality

Inflation heightens social inequality. Quite often those with head starts tends to benefit more from inflation. Producers take advantage of inflation to increases their profits while workers become casualities. This causes frustration among workers and drive instincts for sharp practices or other survival strategies on the worker. At the same time the over empowered wealthy Nigerian occasioned by inflation uses his access to wealth in a manner that will encourage capital flight from the economy.

3.5. Pensioners and Fixed Income Earners

Fixed income and pension income earners have suffered greatly from inflation in Nigeria. Inflation has eroded their spending abilities greatly. Recently, the Kano state Government came to the rescue of pensioners by increasing their norminal earnings from about N200 monthly to N6,000.00 for the minimum pensioner in order to shore up with inflation. N200.00 was a lot of money many years ago, but that amount may not buy a loaf of bread in Nigeria today nor is it enough to serve as transport fare to where the payment could be made. The fall in real incomes impact negatively on the welfare of fixed income earners.

1. DETERMINANTS OF INFLATION IN NIGERIA

Not withstanding, the general theories that explain inflation worldwide, the survey identified these specific sources of inflation in Nigeria. The sources include:

* + - Corruption
    - Incidence of multiple taxation
    - Productivity constraints
    - Poor work ethics
    - inadequate social infrastructure
    - Deficit financing by Government
    - Unplanned wage increases
    - Inadequate storage facilities
    - Import dependence
    - Weak Distribution Mechanism
    - High cost of borrowing
    - Extra economic factors
    - Currency redomination
    - These factors are discussed below
  1. Corruption

It is a known fact that Nigeria is infested with the corruption bug. Its damage to the Nigerian economy is immense. Corruption in Nigeria manifests in different forms, these include extortion from traders and motorists. These in turn pass the burden of such extortions to final consumers. These may be observed at the highways, ports, National borders and even in offices. But, they constitute an unnecessary part of the cost of production in Nigeria. Apart from the usual extortion, there are real offending forms, that chief executives and politicians impose on would be investors or public supported programmes. For example, there is no reason to explain why fuel Premium Motor Spirit (PMS) should be sold beyond N60.00 a litre in Nigeria. Coincidentally, it has been proved that a major source of the high prices paid for fuel is associated with corruption (See Okonjo-Iweala 2012). Apart from the petroleum industry and power supply, many utility providers engage in different forms of sharp practices which ultimately lead to a rise in cost of services. Also those who benefit from sharp practices after tend to spend such sums carelessly. Authors attempt to list out forms of corruption to include (i) bribery (ii) fraud (iii) grand (political) corruption (iv) extortion (v) bureaucratic corruption. But all these impact on cost of output.

* 1. Incidence of Multiple Taxation

The problem of multiple taxation require urgent attention especially in the southern part of Nigeria. There are different tiers of government taxing the same people, the same institutions on similar items. The case is particularly same for companies. The burden of multiple taxes return to consumers as inflation.

* 1. Productivity Constraints

There are structural limitations that affect productivity in Nigeria. For instance, in the agricultural sector, low and obsolete technology is a key limiting factor, poor access to land, use of poor inputs or inputs with poor resistance to disease. All these lead to poor harvests. As a developing society, Nigeria can only boast of few secondary products, thus output is often low. Against limited output, the country has a dense population. This disconnect leads to a situation where there is often competition for available goods and services. This explains why any change in money supply impacts on inflation. The country has capacity to increase output if these constraints are addressed.

* 1. Attitude to Work and Spending Pattern

Over the years, government has been encouraged into many sectors of the economy including sectors traditionally meant for the private sector. This was fueled by the oil boom of the early 1970s. Gradually, a new orientation is observed in Nigeria.

Earnings having no bearing with length of training, ability, amount of work done but on the sector of work and the volume of social network. For instance, if a university graduate of 5 years is employed in a multinational oil company, he could afford to employ and pay a number of his contemporaries from his earnings who do the same kind of job in other sectors particularly the civil service. If he gets a political office, his earnings depend on the particular office but if he works in formal sector (ministry) he is paid in ‘levels’. Output often has little or nothing to do with earnings. So attitude to work is poor. For some people, there is a feeling of discontent, for others, government work is ‘no-body’s business’. And given the large size of government, the impact on output is great. This is further encouraged by institutions which should discourage such poor attitude to work with such aphorisms as work like an ant and eat as elephant,’ do not ‘work as elephant and eat like an ant’. The desire to eat as elephant when you have not worked as elephant encourages attitudes that maximize earnings and prices for minimum output. This drives inflation. Aside this, the spending pattern of many Nigerians is worrisome, many Nigerians enjoy extravagant lifestyles including the consumption of ostentatious goods, naked show of opulence at the private (micro) level. The public sector also get involved in extravagance (See Obiwuru and Udoh, 2011).

* 1. Inadequate Social Infrastructure

The main duties of government include the provision of social infrastructure such as roads, water supply, power, telecommunication, security among others. The provision of these public utilities nets of some cost of production for the private sector and impacts on the cost of final output to the consumer. But in Nigeria, such infrastructure are parlous. In many cases, the investor will need to provide for an alternative source of power, as the public supply is unreliable, the investor may need to construct and maintain the road to the factory, provide alternative supply of water, security among others inspite of huge taxes it may still need to pay. These are the main causes of cost push inflation and uncompetitiveness of locally produced goods and services.

* 1. Deficit Financing by Government

Deficit financing is pervasive in Nigeria, Nigeria depends on oil proceeds to fund it activities and when its expectation are yet to mature, it could borrow. Technically, borrowing may not be harmful, but when an entity persistently overspends its earnings, this becomes a real problem especially if it is spent on recurrent items. Nigeria according to the Radio Nigeria Commentary of 8th  January 2013, is owing N6 trillion domestic debt and $5 billion international debt. Besides, government is the biggest borrower from banks in the local economy.

This effectively limits the ability of the private sector to participate in economic activities ultimately affecting total output and marginal prices. In the 1970s government executed white elephant projects, in the 1980s economic restructuring, in the 1990s, transition to civil rule and in the 2000 decade the building of institutions to strengthen its nascent democratic institutions. These expenditures effectively impact on inflation in Nigeria (see Obiwuru and Udoh, 2011).

* 1. Wage Reviews

Wage reviews are worldwide but in many climes, such reviews are driven by the need to shore up with inflation or to stabilize workers welfare. But in Nigeria especially since wages were deregulated in the 1990s strike actions to press for wage increases have been frequent. Quite often employers are stampeded to wage reviews which are not backed up by productivity. The effect of these is the rise of money supply as against fixed or limited output leading to inflation. Often workers tend to compare their wages with their counterparts in other countries using the extant exchange rate or compare with others in the local economy even in situations where such comparisms do not match.

* 1. Inadequate Storage Facilities

As an agrarian economy, at harvest seasons, excess output need to be preserved for use in times of need. This may be efficiently done using modern technology or storage facilities such as Silos or processed into secondary products, but this is a current challenge in the country. Annually, farmers lose such items as tomatoes, maize, among others to poor storage facilities. This impacts on the morale of farmers as well as total available goods in the market. The effect is scarcity at planting seasons with the consequent rise in prices. The use of obsolete technology has its limitation and there is need for government to encourage pervasive use of home grown technology in the processing of many agricultural output to enhance their shelf life. This will go a long way to keep prices stable.

* 1. Import Dependence

Nigerians have a high penchant for foreign goods. This is partly due to its low industrial status and the flow of economic resources from petroleum products. As at 2008, about N80 billion was targeted for rice imports (a product Nigeria could export). Nigeria imports several agricultural products which she has capacity to be, net exporter for, thus losing substantial revenue from these products (see Otto 2009). Apart from agricultural products, clothes, automobiles and household consumers are imported. Government had tried to encourage the consumption of local goods, but the tendency is that government and its functionaries are good examples of inelasticity in the demand of foreign goods especially health care, transport facilities such as helicopters and airplanes. This dependence has meant that whatever inflation that exists in the international market is imported into the country, so imported inflation is common in

Nigeria.

* 1. Distribution Mechanism

There is a penchant among some Nigerians to work like an “ant” and eat like an ‘elephant’. In other words, these people wish minimum work for maximum pay. Because of this penchant there are many people involved in the distribution channel, adding only little value but extracting much in the process. For example, a contract awarded for the construction of a school building to contractor ‘A’ may be sold to ‘B’ by ‘A’, who then sells the contract documents to ‘C’, C sells to ‘D’ who now attempts to execute the project in a way to maximize gains for himself. This explains low capital output ratio in public projects in Nigeria. Similarly, for private sector goods, a lot of middlemen are lined up between the producer or importer and the final consumer. This may include the owner of the license, the actual importer, the wholesaler, the retailer and a lot more. All these tend to increase the cost of the items. This is without prejudice to many rent seeking and corrupt attitudes that may be imposed on the system..

* 1. Currency Re-domination

Between 1st July 1959 when the Central Bank of Nigeria commenced operation and 2013, the

Nigerian currency has been partially or wholly redominated about twelve times, as follows: 1st July, 1959, 1965, 1968, 1973, 1977, 1981, 1999, 2001, 2005, 2007 and 2012. These include introduction of new currency or the change of existing currencies N100.00, N200.00, N500.00 and N1,000.00 were introduced in December 2009, November, 2000, April 2001 and October 2005 respectively. On February 28, 2007 lower denominations were coined and issued to Bank customers inspite of their protests (See Ezeibe and Onyeagwu. The unit prices of items bought with such denominations rose and had remained high. This snowballed into the prices of other items. This experience has been consistent with such introduction of high denominations.

* 1. High Cost of borrowing

The cost of funds is also a key issue influencing inflation in Nigeria. Capital inadequacy is a constraining factor affecting production in Nigeria. When capital is available its cost is often in the double digits. This high cost is transferred into the cost of output, which the consumer ultimately absorbs. Aside the fact that high cost of borrowing could mean high prices of output, high cost of borrowing discourages investors. It is also a source of unpaid or non-performing loans. Because the interest rates are high and compounding, once total indebtedness become unsustainable, some debtors tend to be discouraged (See Calvo 1992). When many of such situations occur with any bank, the bank may fail, further worsening the economic position of the entire economy.

* 1. Extra-economic Problems

There are several other issues that impact on inflation in Nigeria, these could be social, political, climatic or institutional. For example, the dearth of inputs and factors, encourages market failure in Nigeria. With firms operating as monopolies, oligopolies etc, pricing is manipulated to extract rent incomes. This is further fueled by the premium placed on material trappings by many Nigerians. Aside this the size of the public sector and distributive pattern of central economic resources is usually sub optimal.

1. CONCLUSION AND RECOMMENDATION

This work set out to identify the determinants of inflation in Nigeria. It has identified 13 factors and observed that inflation debilitates the purchasing power of many Nigerians especially civil servants and is one reason to explain the frequency of work stoppages and industrial strikes which in turn lead to rising cost of output in Nigeria. Government must take measures to reduce inflation in Nigeria. These measures may include addressing the problem of double taxation, increasing the availability of social infrastructure among others. These will encourage the private sector to invest in the economy and expand output. An expanded output will lead to more employment and lower cost of goods especially if these goods are driven from the private sector. Because of the intensity of corruption associated with the public sector, the private sector should be encouraged into non sensitive sectors of the economy that can be accommodated by private capital. Stabilizing inflation may also require fiscal correction (See Commander 1992). This can be achieved through cuts in non-capital public spending. Except for security reasons, frequent redenomination of the naira that gulp huge sums of tax payers money should be discouraged, rather such sums should be invested in productive sectors. The Central Bank may also continue with its corrective monetary policies but only after a careful study of the impacts of previous policies.

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