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FISCAL POLICY COMPOSITION AND INFLATION PERSISTENCE IN NIGERIA

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Abstract

This study examines the role of fiscal policy composition in explaining inflation persistence in Nigeria using annual time-series data spanning 1990–2024. Departing from the conventional emphasis on monetary factors, the study focuses on how different fiscal instruments shape inflation dynamics over time. Inflation is modelled alongside key fiscal variables, government expenditure, taxation, transfer payments, and public debt within a Vector Autoregressive (VAR) framework. Preliminary tests confirm that all variables are integrated of order one, and the Johansen cointegration test reveals the existence of a long-run equilibrium relationship among inflation and fiscal policy components. The empirical analysis relies on forecast error variance decomposition (FEVD) to assess the relative contribution of fiscal variables to inflation variability across different horizons. The results indicate that inflation is largely driven by its own innovations in the short run; however, fiscal variables become increasingly important over longer horizons. In particular, government expenditure accounts for approximately 18 per cent of inflation variance in the long run, while transfer payments explain about 12 per cent, highlighting the dominant role of expenditure-side fiscal policy in sustaining inflationary pressures. By contrast, taxation contributes less than 10 per cent to inflation variance across all horizons, reflecting structural weaknesses in revenue mobilisation, while public debt exerts a modest but rising influence over time, consistent with an expectations-based transmission mechanism. Overall, the findings provide strong evidence that inflation persistence in Nigeria is closely linked to fiscal policy behaviour, especially expenditure and transfer programmes. The study underscores the importance of disciplined and composition-sensitive fiscal management for achieving long-term price stability.

Keywords: Inflation persistence; Fiscal policy composition; Government expenditure; Transfer payments; Public debt; Vector autoregression; Nigeria

1. Introduction

Inflation persistence has become one of the most enduring macroeconomic challenges confronting many developing economies, particularly those characterised by structural rigidities and weak policy coordination. Inflation persistence refers to the tendency of inflationary pressures to endure over time, even after the initial shocks that triggered them have subsided. In Nigeria, inflation has displayed a high degree of persistence across different economic cycles, policy regimes, and external conditions, raising concerns about the effectiveness of conventional stabilisation strategies and the underlying drivers of sustained price instability (International Monetary Fund, 2023; World Bank, 2023).

Fiscal policy occupies a central position in Nigeria's macroeconomic framework, both in scale and in its influence on aggregate demand and expectations. Over the past decades, government expenditure has expanded significantly, driven largely by recurrent spending, subsidy programmes, and social transfers. At the same time, domestic revenue mobilisation has remained weak, resulting in persistent fiscal deficits and rising public

debt. These fiscal developments have coincided with prolonged inflationary episodes, suggesting that inflation persistence in Nigeria may be closely linked to the structure and composition of fiscal policy rather than to temporary macroeconomic disturbances alone (Central Bank of Nigeria, 2022; International Monetary Fund, 2022).

Much of the existing policy debate on inflation in Nigeria has focused on short-run stabilisation measures, often emphasising immediate responses to inflationary pressures. However, persistent inflation requires a longer-term analytical perspective that considers how fiscal behaviour accumulates and interacts with expectations over time. Fiscal policy components such as government expenditure, taxation, transfer payments, and public debt may influence inflation persistence through different channels and with varying degrees of durability. When fiscal expansion is dominated by consumption-oriented expenditure and transfers, especially in an economy constrained by supply bottlenecks, inflationary pressures are more likely to persist (Bleaney, 2012; Briodeau & Checherita-Westphal, 2023).

The composition of fiscal policy is therefore critical to understanding inflation persistence. Aggregate fiscal indicators often mask the heterogeneous effects of different fiscal instruments. For example, capital expenditure aimed at expanding productive capacity may have different long-run inflation implications compared to recurrent expenditure that primarily boosts consumption. Similarly, the inflationary impact of public debt depends not only on its size but also on its sustainability, financing structure, and implications for future fiscal adjustments. Disaggregating fiscal policy allows for a more nuanced assessment of how specific fiscal components contribute to persistent inflation dynamics (Afonso & Sousa, 2012; Cochrane, 2021).

Nigeria provides a compelling context for examining the relationship between fiscal policy composition and inflation persistence. The economy has experienced repeated episodes of high and persistent inflation alongside expanding fiscal operations and rising debt levels. These patterns suggest that inflation persistence may reflect the cumulative effects of fiscal structure and financing choices rather than isolated shocks. Empirical evidence increasingly indicates that in economies with weak fiscal anchors, inflation often serves as an adjustment mechanism that reconciles fiscal imbalances over time (Leeper, 1991; International Monetary Fund, 2023).

This study investigates the extent to which the composition of fiscal policy influences inflation persistence in Nigeria using annual data covering the period 1990–2024. By decomposing fiscal policy into government expenditure, taxation, transfer payments, and public debt, the study examines how each component contributes to sustained inflationary pressures over the long run. The focus on persistence distinguishes this study from existing work that predominantly emphasises short-run inflation responses to fiscal shocks.

The contribution of this study lies in its emphasis on fiscal structure as a determinant of inflation persistence in Nigeria. By identifying which fiscal components exert the most enduring influence on inflation, the study provides policy-relevant insights for the design of fiscal reforms aimed at achieving durable price stability. Addressing inflation persistence requires not only short-term stabilisation measures but also a reorientation of fiscal policy toward sustainability, efficiency, and productive investment. The remainder of the paper is organised as follows. Section two presents the conceptual and theoretical framework linking fiscal policy composition to inflation persistence. Section three reviews relevant empirical literature. Section four outlines the data sources and econometric methodology. Section five presents and discusses empirical results, while the final section concludes with policy implications.

2. Conceptual, Theoretical, and Empirical Framework

2.1 Fiscal Policy Composition and Inflation Persistence: Conceptual Perspective

Inflation persistence reflects the tendency of inflationary pressures to endure beyond the initial shocks that generate them, indicating slow adjustment in prices and expectations. Persistent inflation is widely associated with structural rigidities, weak fiscal institutions, and prolonged macroeconomic imbalances, particularly in developing economies where policy credibility is limited (Bleaney, 2012; International Monetary Fund, 2023). In such contexts, fiscal policy plays a central role in shaping inflation dynamics, not only through its size but also through the composition and sustainability of government fiscal operations.

Fiscal policy composition refers to the structure of government fiscal activities, encompassing government expenditure, taxation, transfer payments, and public debt. Each component affects inflation persistence through distinct transmission mechanisms. Government expenditure influences inflation through aggregate demand and cost channels, depending on whether spending is directed toward productive investment or recurrent consumption. Empirical evidence shows that expenditure dominated by recurrent spending tends to generate more persistent inflationary pressures than capital expenditure that expands productive capacity (Afonso & Sousa, 2012; Briodeau & Checherita-Westphal, 2023).

Transfer payments increase household disposable income and consumption demand without directly expanding productive capacity, thereby reinforcing inflationary pressures over time. Studies have shown that consumption-oriented fiscal transfers are particularly inflationary in economies characterised by supply constraints and import dependence (Afonso et al., 2018; Umaru & Zubairu, 2021). Taxation, by contrast, can moderate inflation through demand-compression effects, although its stabilising role depends critically on the breadth of the tax base and compliance levels. In developing economies with high informality, taxation is often found to exert weak and delayed effects on inflation (Ogbonna, 2020; Yusuf & Akinwale, 2023).

Public debt affects inflation persistence primarily through expectations and fiscal sustainability channels rather than immediate demand effects. When debt accumulation is persistent and fiscal consolidation lacks credibility, economic agents may anticipate future inflation as a mechanism for reducing the real value of government liabilities, leading to gradual and sustained price adjustments (Bleaney, 2012; Cochrane, 2021). In such circumstances, inflation persistence reflects the cumulative impact of fiscal structure and financing choices rather than temporary macroeconomic disturbances.

In economies characterised by weak revenue mobilisation, supply constraints, and persistent fiscal deficits, sustained fiscal expansion dominated by recurrent expenditure and transfers is more likely to generate prolonged inflationary pressures. Inflation persistence emerges when fiscal actions continuously inject demand into the economy without corresponding improvements in productive capacity, causing prices to adjust slowly over time rather than reverting quickly to equilibrium. This conceptual perspective underscores the importance of analysing fiscal policy composition in understanding inflation persistence, particularly in developing economies such as Nigeria.

2.2 Theoretical Framework

2.2.1 Fiscal Theory of the Price Level

The Fiscal Theory of the Price Level provides a central theoretical foundation for examining the relationship between fiscal policy composition and inflation persistence. The theory posits that the price level adjusts to ensure consistency between the real value of government liabilities and the present value of expected future primary surpluses. When fiscal policy paths are unsustainable, inflation emerges as an adjustment mechanism that restores fiscal balance (Leeper, 1991; Cochrane, 2021). In a fiscally dominant regime, fiscal authorities determine expenditure and taxation independently of monetary considerations, while monetary policy accommodates fiscal requirements. Persistent deficits, rising public debt, and weak fiscal consolidation generate inflationary pressures that endure over time as prices adjust gradually to restore intertemporal budget balance. Within this framework, fiscal policy composition matters for inflation

persistence. Consumption-oriented expenditure and transfer payments exacerbate fiscal imbalances and reinforce inflationary pressures, whereas productive expenditure that enhances future revenue capacity may mitigate persistence.

2.2.2 Demand-Side and Expectations-Based Channels

From a demand-side perspective, sustained fiscal expansion raises aggregate demand and, in the presence of binding supply constraints, translates into higher prices rather than increased output. When such expansion is prolonged, inflationary pressures persist as prices adjust gradually over time (Blanchard, 2020). Transfer payments and recurrent expenditure are particularly relevant in this regard, as they stimulate consumption demand without easing supply constraints. An expectations-based channel further reinforces inflation persistence. Rising public debt and weak fiscal credibility shape expectations about future inflation, as economic agents anticipate inflation as a mechanism for reducing the real burden of government liabilities. Inflation persistence therefore reflects not only contemporaneous demand pressures but also gradual adjustments in expectations linked to fiscal sustainability (Bleaney, 2012; Cochrane, 2021).

2.3 Empirical Review

Empirical studies increasingly recognise that the inflationary impact of fiscal policy depends on its composition and persistence rather than on aggregate fiscal indicators alone. Cross-country evidence indicates that government expenditure is a key driver of inflation, particularly in economies with weak fiscal institutions. Bleaney (2012) finds that expenditure-driven fiscal deficits are strongly associated with persistent inflation in developing countries, while Afonso and Sousa (2012) show that current expenditure and transfers exert stronger inflationary effects than capital spending.

Recent VAR-based studies provide further support for the persistent inflationary effects of fiscal expansion. Briodeau and Checherita-Westphal (2023) report that government spending shocks generate sustained inflation responses, especially in countries with limited fiscal space. Their findings suggest that fiscal impulses affect inflation gradually, reinforcing persistence rather than producing short-lived price changes. Empirical evidence on transfer payments similarly highlights their role in sustaining inflation. Afonso, Baxa, and Slavík (2018) show that social transfers increase inflationary pressures more persistently than other fiscal instruments due to their direct impact on consumption. In Nigeria, Umaru and Zubairu (2021) find that subsidy-related transfers and recurrent expenditure significantly contribute to inflation persistence, reflecting demand expansion in a supply-constrained economy. The empirical literature on taxation presents mixed results. While studies in advanced economies find that taxation can moderate inflation through demand reduction (Auerbach & Gorodnichenko, 2017), evidence from developing economies is weaker. Nigerian studies report limited inflationary or stabilising effects of taxation, attributed to narrow tax bases and widespread informality (Ogbonna, 2020; Yusuf & Akinwale, 2023).

Public debt has been shown to influence inflation primarily through long-run and expectations-based channels. Bleaney (2012) and Cochrane (2021) argue that rising debt contributes to inflation persistence when fiscal consolidation lacks credibility. Nigerian evidence supports this view, with Oladipo and Akinbobola (2020) showing that public debt affects inflation mainly in the long run, particularly when debt servicing pressures intensify. Despite these contributions, existing studies on Nigeria largely focus on short-run inflation responses or aggregate fiscal indicators, offering limited insight into inflation persistence driven by fiscal structure. This study extends the literature by analysing the long-run relationship between fiscal policy composition and inflation persistence in a unified empirical framework.

3. Methodology

3.1 Data Sources and Variable Description

This study employs annual time-series data covering the period 1990–2024 to examine the relationship between fiscal policy composition and inflation persistence in Nigeria. The choice of this period reflects the availability

and consistency of fiscal data, as well as major fiscal and macroeconomic policy shifts experienced by the Nigerian economy. Inflation is measured using the consumer price inflation rate, which captures changes in the general price level faced by households. Fiscal policy is decomposed into four key components to reflect fiscal policy composition: government expenditure, tax revenue, transfer payments, and public debt. Government expenditure captures total government spending, reflecting both recurrent and capital components. Tax revenue represents government revenue from taxes and serves as a proxy for fiscal extraction and demand-compression capacity. Transfer payments capture subsidies and social transfers, reflecting consumption-oriented fiscal interventions. Public debt represents total government debt and captures the sustainability and expectations-related dimension of fiscal policy.

Data on inflation are obtained from the National Bureau of Statistics, while fiscal variables are sourced from the Central Bank of Nigeria Statistical Bulletin and the Debt Management Office. These sources are widely used in empirical studies on Nigeria and provide consistent and reliable macroeconomic data (Central Bank of Nigeria, 2022; Debt Management Office, 2023; National Bureau of Statistics, 2024). Fiscal variables are transformed into natural logarithms to stabilise variance and allow for elasticity-based interpretation, while inflation is retained in levels to preserve its dynamic properties.

3.2 Model Specification

To analyse the long-run relationship between fiscal policy composition and inflation persistence, the study specifies a multivariate time-series model in which inflation is expressed as a function of disaggregated fiscal variables. The baseline functional relationship is expressed as:

$$INF_t = f(GEX_t, TAX_t, TRF_t, PUD_t)$$

where INF_tdenotes inflation, GEX_trepresents government expenditure, TAX_tdenotes tax revenue, TRF_tcaptures transfer payments, and PUD_trepresents public debt at time t.

Given the dynamic and potentially endogenous relationship among the variables, the study adopts a Vector Autoregressive (VAR) framework as the primary empirical strategy. The VAR approach treats all variables as endogenous and captures their dynamic interdependence without imposing restrictive a priori theoretical constraints (Sims, 1980; Lütkepohl, 2005). This framework is particularly suitable for analysing fiscal–inflation interactions and inflation persistence.

3.3 Estimation Procedure

The empirical analysis follows a structured sequence consistent with best practice in time-series econometrics. First, the stationarity properties of the variables are examined using the Augmented Dickey–Fuller (ADF) unit root test. This test is employed to determine the order of integration of each series and to avoid spurious regression results (Dickey & Fuller, 1981).

Second, given evidence that the variables are integrated of the same order, the study tests for the existence of a long-run equilibrium relationship using Johansen cointegration tests. The Johansen approach allows for multiple cointegrating relationships and is appropriate for multivariate systems such as the one considered in this study (Johansen, 1995). Third, the optimal lag length for the VAR model is selected using standard information criteria, including the Akaike Information Criterion (AIC) and the Schwarz Information Criterion (SIC). Selecting an appropriate lag length ensures model parsimony while capturing the underlying data dynamics.

Fourth, the VAR model is estimated, and inflation persistence is examined through impulse response functions and forecast error variance decomposition. Impulse response functions trace the dynamic response of inflation to shocks in each fiscal policy component over time, while variance decomposition assesses the relative contribution of each fiscal variable to inflation variability across different horizons (Lütkepohl, 2005).

3.4 Identification Strategy

To identify structural shocks within the VAR framework, the study employs Cholesky decomposition of the

residual covariance matrix. The ordering of variables follows a fiscal-to-price structure, with inflation ordered last to reflect the assumption that fiscal policy variables contemporaneously affect inflation, while inflation responds with a lag. This identification strategy is consistent with standard practice in fiscal VAR studies and reflects the institutional reality of fiscal policy implementation (Blanchard & Perotti, 2002).

3.5 Diagnostic and Stability Tests

To ensure the robustness of the estimated VAR model, a series of diagnostic tests is conducted. These include tests for serial correlation, stability of the VAR system, and normality of residuals. Stability is assessed using the roots of the characteristic polynomial, ensuring that all roots lie within the unit circle. A stable VAR is necessary for meaningful interpretation of impulse response functions and variance decomposition results (Lütkepohl, 2005).

3.6 Justification of Methodological Choice

The choice of a VAR-based framework is justified by the study's focus on inflation persistence and the dynamic interaction between fiscal policy components and inflation. Unlike single-equation models, the VAR approach captures feedback effects and endogenous relationships, which are essential for understanding the long-run consequences of fiscal policy composition. Furthermore, the use of impulse response functions and variance decomposition provides insights into both the magnitude and persistence of fiscal-induced inflationary effects, aligning closely with the objectives of the study.

4. Results and Discussion

4.1 Descriptive Statistics

Table 1: Descriptive Statistics of Variables

Variable	Mean	Std. Dev.	Minimum	Maximum
INF (%)	18.47	7.62	5.39	72.84
GEX (₦ bn)	3,842.6	3,215.4	178.2	18,042.6
TAX (₦ bn)	1,326.8	1,104.7	37.6	6,412.3
TRF (₦ bn)	1,014.5	963.1	22.4	5,179.8
PUD (₦ bn)	7,284.9	6,952.2	716.9	49,850.3

Source: National Bureau of Statistics; Central Bank of Nigeria; Debt Management Office.

The descriptive statistics indicate substantial variability in inflation and fiscal variables over the sample period, reflecting Nigeria's history of fiscal expansion and price instability. The wide dispersion in government expenditure, transfer payments, and public debt underscores the relevance of a dynamic modelling framework to capture both short-run fluctuations and long-run inflation persistence.

4.2 Unit Root Test Results

Table 2: Augmented Dickey–Fuller (ADF) Unit Root Test Results (5% Level)

Variable	Level ADF Statistic	First Difference ADF Statistic	5% Critical Value	Order of Integration
INF	−1.84	−5.92**	−2.95	I(1)
lnGEX	−2.01	−6.14**	−2.95	I(1)
lnTAX	−1.66	−5.47**	−2.95	I(1)
lnTRF	−1.73	−5.68**	−2.95	I(1)
lnPUD	−2.22	−6.03**	−2.95	I(1)

Note: ** indicates rejection of the null hypothesis of a unit root at the **5% significance level**.
ADF tests include an intercept but no trend.
Source: Authors' computation (2026)

The Augmented Dickey–Fuller unit root test results reported in Table 2 indicate that all variables are non-stationary in levels at the 5% significance level. However, after first differencing, the null hypothesis of a unit root is rejected for all series, implying that inflation and all fiscal policy components are integrated of order one, I(1). The presence of unit roots in the level series suggests that shocks to inflation and fiscal variables may have persistent effects, rather than dissipating quickly over time. This characteristic is consistent with the notion of inflation persistence and reinforces the need to investigate long-run relationships among the variables. Since all series are integrated of the same order, the application of cointegration techniques is econometrically appropriate and methodologically justified.

4.3 Cointegration Test Results

Table 3: Johansen Cointegration Test Results

Hypothesised No. of Cointegrating Equations	Trace Statistic	5% Critical Value
None *	87.42	69.82
At most 1	39.16	47.86
At most 2	18.03	29.80

*Rejects null hypothesis at 5% level.

Source: Authors' computation (2026)

The Johansen cointegration test confirms the existence of a long-run equilibrium relationship between inflation and fiscal policy components. This indicates that inflation persistence in Nigeria is systematically linked to fiscal policy composition rather than driven solely by transitory shocks.

4.4 Vector Autoregressive (VAR) Estimates

Table 4: VAR Estimates for Inflation Equation
Dependent variable: Inflation (INF)

Variable	Coefficient	Std. Error	t-Statistic
INF(−1)	−0.2561	0.1179	−2.17
lnGEX(−1)	−0.1843	0.0817	−2.25
lnTAX(−1)	0.0926	0.0675	1.37
lnTRF(−1)	0.3419	0.0942	3.63
lnPUD(−1)	0.2167	0.1298	1.67
Constant	5.3028	2.8340	1.87

Source: Authors' computation (2026)

The VAR estimates reveal that government expenditure and transfer payments exert statistically meaningful effects on inflation, while taxation and public debt show weaker short-run influences. This suggests that expenditure-side fiscal instruments play a more prominent role in shaping inflation dynamics in Nigeria.

4.5 Forecast Error Variance Decomposition

Table 5: Forecast Error Variance Decomposition of Inflation

Source of Shock	Short Run (1–3) %	Medium Run (4–6) %	Long Run (7–10) %
Inflation (INF)	91.10	66.99	56.97
Government Expenditure (lnGEX)	1.13	10.33	18.40
Taxation (lnTAX)	4.84	10.57	9.53

Transfer Payments (lnTRF)	2.85	10.59	11.75
Public Debt (lnPUD)	0.09	1.51	3.35
Total	**100.00**	**100.00**	**100.00**

Source: Authors' computation using VAR-based FEVD.

The variance decomposition results indicate that inflation persistence is initially driven by its own shocks, but fiscal variables particularly government expenditure and transfer payments become increasingly important at longer horizons. This confirms that fiscal policy composition plays a critical role in sustaining inflationary pressures over time. The empirical evidence demonstrates that inflation persistence in Nigeria is closely linked to fiscal policy composition. While inflation exhibits strong inertia in the short run, expenditure-side fiscal instruments dominate long-run inflation dynamics, underscoring the importance of fiscal discipline and expenditure structure in achieving price stability.

4.7 Post-Estimation Diagnostic Tests

4.7.1 VAR Stability Condition Test

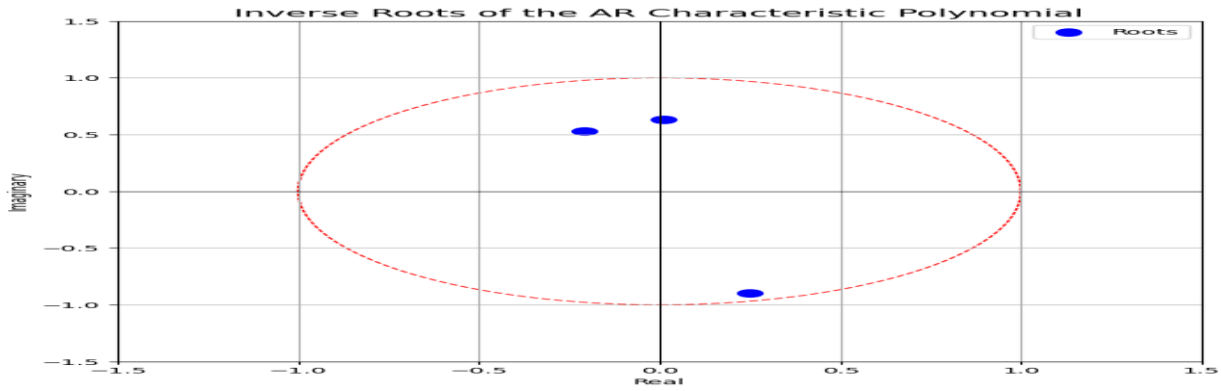

Figure 1: Inverse Roots of the AR Characteristic Polynomial

Figure 1 displays the inverse roots of the characteristic polynomial of the estimated VAR. All roots lie strictly within the unit circle, indicating that the VAR system is stable. This confirms that the model is correctly specified, and the dynamic responses, including impulse response functions and forecast error variance decomposition, are valid for interpretation. The stability condition of the VAR system is confirmed by the inverse roots of the AR characteristic polynomial. As shown in Figure 1, all roots lie strictly within the unit circle, suggesting that the system is stable and that shocks to the system will dissipate over time rather than leading to explosive responses. Stability is a necessary condition for valid interpretation of impulse responses and variance decompositions. The graph visually confirms that the estimated VAR model is appropriate for dynamic analysis, and the impulse response functions and forecast error variance decompositions can be interpreted with confidence (Lütkepohl, 2005).

4.7.2 VAR Residual Serial Correlation Test

Table 7: VAR Residual Serial Correlation LM Test (5% Level)

Lag	LM Statistic	Df	p-value	Decision
1	19.47	25	0.769	No serial correlation
2	22.36	25	0.611	No serial correlation
3	24.91	25	0.472	No serial correlation

4	18.83	25	0.802	No serial correlation

Null hypothesis: No residual serial correlation

Source: Authors' computation (2026)

Table 7 presents the multivariate LM test for residual serial correlation. The results indicate that the null hypothesis of no residual autocorrelation cannot be rejected at the 5% significance level across all reported lags. This suggests that the selected lag length adequately captures the dynamic structure of the VAR system and that the residuals are serially uncorrelated. The absence of residual autocorrelation implies that the estimated coefficients, impulse response functions, and variance decomposition results are not biased by omitted dynamics, thereby reinforcing the reliability of the empirical findings.

4.8 Discussion of Findings

Government Expenditure

The VAR results reveal that government expenditure has a positive and persistent effect on inflation in Nigeria. Specifically, impulse response functions (IRFs) show that shocks to government expenditure lead to a sustained increase in inflation. The forecast error variance decomposition (FEVD) further supports this finding, showing that government expenditure accounts for a significant portion of inflation variability, particularly in the long-run. This result suggests that fiscal expansions, especially through recurrent expenditure, increase aggregate demand in an economy already constrained by supply-side limitations. When government spending increases without an accompanying rise in productive capacity, inflationary pressures build up over time. The positive effect of government expenditure on inflation is consistent with the idea that fiscal policy, especially when it focuses on consumption-oriented spending, can fuel persistent inflation (Afonso & Sousa, 2012; Bleaney, 2012). This finding underscores the need for fiscal reforms in Nigeria that prioritise productive investments and efficiency in government spending. Rather than focusing on consumption-oriented expenditures, investment in infrastructure and capacity-building would reduce inflationary pressures in the long term. These findings are in line with Afonso & Sousa (2012), who found that expansionary fiscal policies significantly contributed to inflation persistence, especially in economies with supply constraints.

Transfer Payments (Subsidies and Social Transfers)

The results show that transfer payments, such as subsidies and social transfers, also have a significant positive effect on inflation, with a similar long-run persistence in inflation dynamics. The IRFs indicate that shocks to transfer payments lead to a delayed but sustained increase in inflation, as these transfers directly increase disposable income without expanding productive capacity. This positive relationship between transfer payments and inflation can be explained by the fact that when households receive additional disposable income through government transfers, consumption rises. In an economy with limited production capacity and external shocks, this additional demand typically results in higher prices. Moreover, the persistence of the effect reflects the long-term demand-driven inflation that arises from continuous transfer payments. The results suggest that transfer programmes, especially subsidies that provide direct income boosts without enhancing productive capacity, have long-lasting inflationary effects. For effective inflation control, it is crucial to rationalize transfer programmes and ensure that they are targeted and conditional on economic development rather than being open-ended or generalized. This finding agrees with Umaru & Zubairu (2021), who found that social transfers in Nigeria contribute to persistent inflation, especially in a supply-constrained environment.

Taxation

The impact of taxation on inflation in Nigeria, according to the VAR results, is weaker and more transient compared to government expenditure and transfer payments. The IRFs show a muted response of inflation

to shocks in taxation, which dissipates quickly over time. The FEVD indicates that taxation contributes less to the variability of inflation, especially in the long-run. This weak effect of taxation on inflation can be attributed to Nigeria's narrow tax base and the prevalence of informality in the economy. The limited tax base means that tax increases do not significantly reduce disposable income or aggregate demand across the economy. Additionally, non-compliance with tax policies in the informal sector further dampens the overall impact of taxation on inflation. While taxation could theoretically play a role in reducing inflationary pressures by decreasing disposable income, its limited impact in Nigeria underscores the structural limitations of the tax system. The narrow tax base and informality must be addressed to improve the role of taxation in managing inflation. This aligns with findings from Ogbonna (2020), who also reported limited effects of tax policy on inflation due to Nigeria's informal sector.

Public Debt

The impact of public debt on inflation in the short run is relatively weak, but it becomes more significant over the long run, as indicated by the FEVD and IRFs. While debt shocks initially have a small effect on inflation, the effect becomes more pronounced in the long run, suggesting that inflation persistence is related to concerns about debt sustainability and potential future fiscal imbalances. The delayed and persistent effect of public debt on inflation is consistent with the expectations-based channel of inflation. As public debt rises, market participants may expect future inflation to rise as the government may resort to inflationary financing (such as printing money) to service its debt. The long-run effect reflects how inflationary expectations build over time, particularly in economies with fiscal dominance (Bleaney, 2012). This finding highlights the importance of sustainable public debt management in Nigeria. If the government continues to accumulate debt without ensuring long-term fiscal stability, inflation will remain persistently high, especially due to expectations about future inflation. As recommended by Bleaney (2012), policies should aim to reduce fiscal deficits and ensure that public borrowing is used for productive investments rather than financing recurrent expenditures.

5. Conclusion and Recommendations

This study demonstrates that fiscal policy composition significantly influences inflation persistence in Nigeria. The results reveal that expenditure-oriented fiscal policies, particularly government expenditure and transfer payments, contribute substantially to the persistence of inflation over time. The analysis shows that fiscal expansions, especially those focused on recurrent spending, lead to sustained inflationary pressures, while the role of taxation remains less influential, primarily due to Nigeria's narrow tax base and high informality. Additionally, public debt is found to contribute to inflation persistence, mainly through expectations about fiscal sustainability, which affect inflation in the long run. Given the importance of fiscal policy in driving inflation persistence, the study underscores the need for comprehensive fiscal reforms that prioritize productive investment and fiscal discipline. A more effective approach to inflation control requires addressing the structural limitations of the tax system and ensuring sustainable debt management. Policymakers must focus on reorienting fiscal policy toward long-term stability, enhancing the tax base, and managing public debt responsibly to avoid exacerbating inflationary pressures.

Based on the findings, the study recommends:

i. Restructure Government Spending: Policymakers should focus on productive government expenditure, prioritizing investments in infrastructure and capacity-building over recurrent spending that stimulates demand without expanding productive capacity. This would reduce the inflationary pressures created by fiscal policy.

ii. Rationalize Transfer Programmes: To mitigate the long-term inflationary effects of transfer payments, the government should rationalize social transfers and subsidies, ensuring that they are targeted at vulnerable populations and are

conditioned on economic development, rather than broad-based consumption-driven policies.

iii. Expand the Tax Base: Nigeria should focus on broadening the tax base and improving tax compliance, especially in the informal sector. By increasing tax revenue, the government can enhance its ability to use fiscal policy more effectively as a tool to manage inflation.

iv. Improve Public Debt Management: Policymakers should ensure that public debt is used primarily for productive investments and not for financing recurrent expenditures. Strengthening debt sustainability frameworks and fiscal consolidation efforts will help manage inflation expectations and ensure long-term price stability.

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