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Government Expenditure And Economic Growth In Nigeria

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ABSTRACT
This study investigated the impact of government expenditure on economic growth in Nigeria between 1981 and 2016. Data were collected from CBN (2016) statistical bulletin. Real Gross domestic Product (RGDP) was proxy for economic growth while Government capital Expenditure (GCE), Government Recurrent Expenditure (GRE) and Credit to the Private Sector (CPS) were proxies of government expenditure. To use the Ordinary Least Square (OLS) technique, the data were tested for unit root using the Augmented Dickey-Fuller test, the results showed all the variables became stationary at first difference. The Johansen Co-integration test revealed the existence of long-run relationship among the variables. Thus, our findings showed that GCE was inversely related to RGDP both in short run and in the long run. GRE was positively related to RGDP both in the long run and in the short run and there was inverse relationship between CPS and RGDP both in the short run and in the long run. However, with a low ECM (-1) of approximately 3% speed of convergence to equilibrium in the long run, it is clear that the short run dynamic disequilibrium was slow and statistically insignificant to converging to long run equilibrium, implying that government expenditures have no long run impact on economic growth in Nigeria. The study thus recommended among others that the government should re-evaluate her capital expenditure component to ensure that funds are utilized on projects with socio-economic impact on the economy, eliminate leakages associated with misappropriation and embezzlement as well as ensure adequacy of funds on capital project in the right proportion in line with global best practices to stimulate long run impact of government expenditure on real growth of the Nigerian economy.
Keywords: government expenditures, economic growth, Private Sector

INTRODUCTION

Keynesian economics emphasized the need for government intervention in the economy through expenditure programmes that would eventually foster the growth of the economy. Government expenditure therefore, as an aspect of fiscal policy has remained an indispensable task on governments for countries across the globe regardless of the economic system in practice. However, the Classical school and its followers believe that fiscal policy is ineffective in terms of ensuring macroeconomic growth on the grounds of crowding-out effects. According to this assumption, as government expenditure increases, the provision of public goods are substituted for private goods, hence causing decrease in private spending on basic infrastructure and other related services. In addition, when government borrows domestically to finance certain expenditure programmes, increase demand in the borrowing institutions will produce higher interest rates in the long-run which discourage private investment due to shortfall in borrowed capital available to prospective investors. In other words, public sector spending may also discourage economic activities and private sector participation. Take for instance, competition between unproductive public sector and efficient private sector in the financial market to seek for loanable funds sometimes causes an increase in the rate of interest, which decreases private investment and ultimately discourage productivity and output growth. Likewise, a number of unproductive taxes imposed by the public authority can hinder the market efficiency and resource allocations. Apart from the Keynesian propositions, the debate on the effectiveness of fiscal policy to encourage sustainable growth has gained

additional support in the literature with the emergence of Barro endogenous growth model and other related growth theories (Miftahu and Rosni, 2017). In further recognition of the crucial nature of government expenditure, Miftahu and Rosni (2017) held that government expenditure occurs in an economy for two major reasons:

(i) To provide the necessary and required facilities needed for the maintenance of law and order and further enhance allocative efficiency in the presence of externalities and also

(ii) To provide all the necessary and required infrastructural facilities that will heighten productivity and encourage economic activities in the long-run. Consequently, Abu and Abullahi (2010) summarized the two functions of government as protection or security and provisions of certain public goods. The Protective function entails creation of rule of law and enforcement of property rights which helps to minimize risks of criminality, protect life and property, and the nation from external attacks; while defense, roads, education, health, power, etc are goods provided by government. The crucial needs for government to participate in the economy can be seen from the need to enforce contracts, protect property, and develop infrastructure (Abdullah, 2000; Njoku & Nwaeze, 2014). In Nigeria, public expenditures are broadly categorized into capital and recurrent expenditure. The recurrent expenditure are government expenses on administration such as wages, salaries, interest on loans, maintenance etc., whereas expenses on capital projects like roads, airports, health, education., telecommunication, electricity generation etc., are referred to as capital expenditure (Obinna, 2003). The size of government expenditures and its effect on economic growth, and vice versa, has been an issue of sustained interest for several decades now. The relationship between government expenditure and economic growth has continued to generate series of debate among scholars. Some have argue that increase in government expenditure on socio-economic and physical infrastructures encourage economic growth. For example, government expenditure on health and education raises the productivity of labour and increase the growth of national output. Similarly, expenditure on infrastructure such as roads, communications, power, etc, reduces production costs, increases private sector investment and profitability of firms, thus fostering economic growth. As observed by Al-Yusuf and Couray (2009), Abdullah (2000), Ranjan, Sharma, (2008) and Cooray (2009) the expansion of government expenditure contributes positively to economic growth. In Olukoye (2009) the general view is that public expenditure either recurrent or capital expenditure, notably on social and economic infrastructure can be growth-enhancing. The provision of infrastructural services to meet the demands of business, households, and other users is one of the major challenges of economic development in developing countries like Nigeria. It is also true that to finance government programmes, a crucial component or source of funding is borrowing. Acccording to Okonjo-Iweala (2011), the domestic debt profile has been rising astronomically and if not controlled could create some unfavorable consequences as crowding out private sector investment, poor GDP growth etc,. With rising government expenditure profile over the years accompanied by astronomically increasing deficit financing especially in the recent federal government budgets in Nigeria alongside instability in economic growth and the recent economic recession, a critical research is reignited in the relationship between government expenditure and economic growth. The main objective of this study is to investigate the impact of government expenditure on economic growth in Nigeria. Thus, the paper is guided by the following research hypotheses:

(i) That there is no significant relationship between government capital expenditure and economic growth in Nigeria.

(ii) That there is no significant relationship between government recurrent expenditure and economic growth in Nigeria and

(iii) That there is no significant relationship between government domestic debts and economic growth in Nigeria. Following the importance attached to the role of government in fostering and achieving the macroeconomic objectives of the country especially the critical need to grow the Nigerian economy into a self-reliant, strong and relatively stable one, this study is prompt and timely for government policy makers, the private sector and to add value to the stock of existing knowledge.

The study covers the period between 1981 and 2016. The time period chosen for this study is considered large enough to allow for the normality of the time series data required for the ordinary least square technique of analysis. Thus, the structure of the paper is as follows. After the introduction part, section 2 provides a brief review of the literature on government expenditure and economic growth in Nigeria. Estimation strategy and model specification are describe in section 3. Section 4 discussed the empirical results in the study and sections 5 and 6 are the policy implication and recommendation and conclusions respectively.

2. BRIEF REVIEW OF RELEVANT LITERATURE

Many empirical studies have put to test the predictions of endogenous growth theory since it provides governments a theoretical basis for active participation in the growth process of developing economies (see Buti and Van den Noord, 2003; Fatas et al, 2003; Hughes-Hallet et al, 2004; Gali and Perotti, 2003 and Suleiman, 2010). Such studies have been spurred by the need to gain more insight into the nature of the relationship between government expenditure and economic growth and, thus, better understanding of the issues relating to ever increasing public expenditure in the short, medium and long terms. Other researchers have examined the effect of government expenditure on economic growth. Laudau (1983) examined the effect of government expenditure on economic growth for a sample of 96 countries. He found that government expenditure exerts a negative effect on real output. Similarly, Komain et al (2007), employing the Granger causality test, examined the relationship between government expenditures and economic growth in Thailand and found that government expenditures and economic growth are not cointegrated. The result also suggested that a unidirectional relationship, as causality runs from government expenditures to growth. However, the result indicated a significant positive effect of government spending on economic growth.

In their study, Olugbenga and Owoeye (2007) investigated the relationships between government expenditure and economic growth in a group of 30 OECD countries for the period 1970-2005 using regression analysis. Their analysis showed that a long-run relationship exists between government expenditure and economic growth. The study also indicated a unidirectional causality from government expenditure to growth for 16 of the countries, thus supporting the Keynesian hypothesis government intervention. But, causality runs from economic growth to government expenditure in 10 of the countries, thereby confirming the Wagner's law. For the remaining four countries, findings indicated existence of feedback relationship between government expenditure and economic growth. In their empirical analysis of the relationship between government expenditure and economic growth, Folster and Henrekson (2001) employed various econometric approaches to study a sample of wealthy countries for the period 1970 to 1995. Based on their findings, they submitted that that more meaningful and reliable results are generated, as economic problems are addressed.

A study by Ranjan and Sharma (2008) showed that government expenditure exerted significant positive impact on economic growth in India during the period 1950-2007, and that the two sets of variables cointegrated.

Cooray (2009) employed an econometric model that incorporates government expenditure and quality of governance in a cross-sectional study of the relationship between government expenditure and economic growth in 71 countries. The results showed that both the size and quality of governance correlated positively with economic growth. In their own study, Abu-Bader and Abu-Qarn (2003) used multivariate co integration and variance decomposition approach to analyze the causal relationship between government expenditures and economic growth in Egypt, Israel, and Syria. The variables used in the analysis included share of government civilian expenditures in GDP, military burden, and economic growth. They observed that, in the bivariate framework, a bi-directional and long run negative relationships existed between government spending and economic growth. But the causality test within the trivariate framework based on the above variables indicated that military burden has a negative impact on economic growth in all the countries, while civilian government expenditures have positive effect on economic growth for both Israel and Egypt. In a study of government expenditure and economic growth in the United States, Liu et al (2008) examined the causal relationship between GDP and public

expenditure for the period 1947-2002. The causality results revealed that while total government expenditure causes growth of GDP, the latter does not cause expansion of government expenditure. The study concluded that since public expenditure grows the US economy, based on the causality test, Keynesian hypothesis exerts more influence than the Wagner's law in US. Using data set on Greece, United Kingdom and Ireland, Loizides and Vamvoukas (2005) employed the trivariate causality test to investigate the relationship between government expenditure and economic growth. The result showed that size of government granger-causes economic growth in the three countries. Such growth was experienced both in the long and short runs in Ireland and the UK. When inflation is included in the analysis, the result showed that economic growth granger causes public expenditure expansion in Greece and the UK. Donald and Shuanglin (1993) investigated the differential effects of various categories of expenditures on economic growth for a sample of 58 countries. Their findings suggested that while government expenditures on education and defence have positive effect, expenditure on welfare has insignificant negative effect on economic growth. An obvious deficiency of economic theory is that it does not provide a well- developed methodology to incorporate government expenditures in standard growth models. To assuage this, empirical studies have been carried out to establish a relationship between size of government and economic growth. While some studies have found a negative relationship between government expenditure and economic growth (Landau, 1986; Grier and Tullock, 1989; Barro, 1990), others have found a positive relationship (Ram, 1986 and Aschauer, 1989).

In Nigeria, many studies have attempted to investigate the relationship between government expenditure and economic growth, and the impact thereof. Oyinlola (1993) used defense expenditure and economic growth in Nigeria, and found a positive relationship between defence expenditure and economic growth. Okoro (2013) examined the relationship between government spending and economic growth in Nigeria using time series data of 32 years period (1980-2011), this study investigated the impact of government spending on the Nigerian economic growth. Employing the ordinary least square multiple regression analysis to estimate the model specified. Real Gross Domestic Product (RGDP) was adopted as the dependent variable while government capital expenditure (GCEXP) and government recurrent expenditure (GREXP) represents the independent variables. With the application of Granger Causality test, Johansen Cointegration Test and Error Correction Mechanism, the result shows that there exists a long-run equilibrium relationship between government spending and economic growth in Nigeria. The short-run dynamics adjusts to the long-run equilibrium at the rate of 60% per annum.

Empirical analysis by Fajingbesi and Odusola (1999) showed that government capital expenditure has a significant positive effect on real output, but that real government recurrent expenditure has insignificant effect on growth. The study by Ogiogio (1995) indicated a long-term relationship between government expenditure and economic growth. The result also showed that recurrent expenditure exerts more effect than capital expenditure on economic growth. However, some empirical studies in Nigeria suggest no long-run relationship between government expenditure and economic growth (Aigbokhan, 1996; Essien, 1997; Aregbeyen, 2006; Babatunde, 2007). Thus, there appears to be a controversy over the long run relationship between government expenditure and economic growth in Nigeria.

Akpan (2005) used a disaggregated approach to examine the relationship. Components of public expenditure considered in his analysis were capital, recurrent, administrative, economic service, social and community service, and transfers. The study found no significant relationship between economic growth and most components of government expenditure in Nigeria.

Nurudeen and Usman (2010) observe that rising government expenditure has not translated to meaningful development as Nigeria still ranks among world's poorest countries. Using disaggregated analysis approach, they investigated the effect of government expenditure on economic growth in Nigeria in the period 1970-2008 and found that government total capital expenditure, total recurrent expenditure and expenditure on education have negative effect on economic growth; but rising government expenditure on transportation and communication, and health exerts positive effect on economic growth. However, this study faults the extent of disaggregation of the data that constituted variables of research interest in Nurudeen and Usman's study since expenditure on education, transportation and communication and health must have been part of total capital and total recurrent expenditure respectively.

Suleiman (2009) observes that such understanding could help to assess the impact on government expenditures and then on deficits arising from a structural deceleration in or from an improvement in the growth potential. He submits that a good knowledge of the structural relation between the non-cyclical component of government expenditure and potential output is key to obtaining a benchmark against which to evaluate the stance of expenditure policy and then of overall fiscal policy.

Consequently, he empirically examined the relationship between government revenues and expenditures, expenditures and economic growth as a fundamental step in understanding the behaviour of Nigerian public expenditure and the economy. His study found support for Wagner's law of ever increasing public finance and Friedman's Hypothesis. The study also showed that growth in real GDP was significant before the mid-1990s but thereafter fell below average government revenue and expenditure. He concluded that, during the period 1978–2008, government expenditure was not employed as a fiscal instrument and that revenue growth drove the government expenditure.

3. ESTIMATION STRATEGY AND METHODOLOGY

In other to achieve the objective of the study, a multiple regression model of ordinary least squares (OLS) technique is used with Real Gross Domestic Product (RGDP) as the dependent variable and proxy for economic growth while Government Capital Expenditure (GCE), Government Recurrent Expenditure (GRE) and Credit to the Private Sector (CPS) were used as proxies of Government Expenditure and independent variables. The model is specified in the functional form below as:

$RGDP = F(GCE, GRE, CPS)$……(3.1)

Expressing equation (3.1) in explicit linear econometric model below gives:

$RGDP = \lambda o + \lambda 1GCE + \lambda 2GRE + \lambda 3CPS + \mu t$……..(3.2)

Theoretically from equation 3.2, it is expected that government capital expenditure on infrastructure be positively related to real growth of the economy, government recurrent expenditure on administration of its functions be positively related with the real growth of national income. Also, in line with the endogenous growth model, credit to the private sector is expected to stimulate private investment and thus the growth of output in the economy. The apriori economic expectation of size therefore is given as: $\lambda 1 > 0$, $\lambda 2 > 0$ and $\lambda 3 > 0$ The data for this paper consists of annual time series from 1981 – 2016, obtained from the Central Bank of Nigeria (2016) Statistical Bulletin.

4. Data Presentation

Table 4.1 Descriptive Statistics

	RGDP	GCE	GRE	CPS
Mean	31822.97	361.3571	1068.409	3878.163
Maximum	69023.93	1152.800	4178.590	21082.72
Minimum	13779.26	4.100000	4.750000	8.570000
Std Dev.	18304.31	363.8299	1392.007	6434.247
Probability	0.072780	0.159602	0.029360	0.000902
Observations	36	36	36	36

Source: Author's computation with the use of E-views9

From table 4.1 Nigeria Real Gross Domestic Product (RGDP) averaged ₦31,822.97 billion between 1981 and 2016. The maximum RGDP within the said period was ₦69, 023.93 billion, while the minimum RGDP was ₦13, 779.26 billion for the period. Government Capital Expenditure (GCE) averaged ₦361.3571 billion in 36 years. The maximum GCE for the said period was ₦1152.800 billion and the minimum GCE was ₦4.100000. Government Recurrent Expenditure (GRE) had an average of ₦1068.409 billion within the period covered. The maximum GRE was ₦4178.590 while the minimum GRE was ₦4.750000 for the said period. Credit to the Private Sector (CPS) averaged ₦3878.163 billion, the maximum CPS was ₦21082.72 and the minimum was ₦8.570000 for the period. GRE and CPS were statistically significant as their values were 0.029360 and 0.000902 respectively. The other variables did not show significance at 5% level.

Table 4.2 ADF Unit Root Test Results

Variables	Levels	**1st Difference**	Lag(s)	**Model**	**Order of Integration**
RGDP	-1.961114	-7.332676	2	Trend & Intercept	I(1)
GCE	-2.400238	-7.359005	2	Trend & Intercept	I(1)
GRE	-0.670855	-3.887583	2	Trend & Intercept	I(1)
CPS	-2.200343	-5.056422	2	Trend & Intercept	I(1)
ECM	-2.150910		2	None	I(0)
Critical Value @ 5% Level	-3.562882	-3.548490	2		

Source: Author's computation with the use of E-views9

Table 4.2 shows that at 5% level of significance the variables were all integrated at first difference I(1). Theoretically, a variable is said to be stationary if the test statistics in absolute terms is greater than the critical value. The next test in order to establish whether the non-stationary variable could be co-integrated after identifying the order of integration is co-integration test. The co-integration of two time series data suggests that there exist a long-run relationship between them. The Johansen co-integration test was employed to examine the relationship among the variables. The results obtained showed the existence of a long run relationship as it indicates two co-integrating equation at 5% significance level for both the Trace Statistic and the Max-Eigen Statistic as summarized in table 4.3 below.

Table 4.3 Johansen Cointegration Test Result

Series: RGDP, GCE, GRE, CPS.				
Hypothesized No, of CE(s)	Trace Statistic	Prob. Value	Max-Eigen Statistic	Prob. Value
None*	120.0105	0.0000	62.60060	0.0000
At most 1	57.40986	0.0010	35.56289	0.0019
At most 2	21.84697	0.1462	15.18524	0.1838
At most 3	6.661728	0.3811	6.661728	0.3811

Source: Author's computation with the use of E-views9

Though the variables included in a model may be cointegrated, there may exist short-run disequilibrium between the response variable and the explanatory variables. Thus, the error correction mechanism allows for the correction of any short-run disequilibrium in a dynamic model like ours. Accordingly, an over-

parameterized model that lags the variables for subsequent elimination of the insignificant variables is experimented to derive a Parsimonious error correction model. Thus the result of the Parsimonious Error Correction Model is shown in table 4.4 below.4.3

Estimation Results

Table 4.4 Parsimonious ECM Result
Dependent Variable: RGDP

Variable	Coefficient	Std. Error	t-Statistic	Prob. Value
C	691.4969	203.0316	3.405858	0.2988
D(GCE)	-4.499804	1.892166	-2.378123	0.0876
D(GCE(-4))	-7.375809	2.088346	-3.531890	0.2465
D(GRE)	4.173506	1.829410	2.281340	0.1110
D(GRE(-2))	5.582622	1.602057	3.484658	0.0053
D(GRE(-3))	4.814463	1.044656	4.608660	0.0174
D(GRE(-4))	6.933599	2.107112	3.290570	0.0006
D(CPS)	-1.203398	0.328761	-3.660402	0.1005
D(CPS(-2))	-1.352534	0.623079	-2.170726	0.5128
ECT(-1)	-0.027668	0.104314	-0.265235	0.0000
R-Square=0.827882 **Adjusted R-square= 0.724611** **Prob.(F.Stat)= 0.000256** **Durbin-Watson Stat= 2.306096**				

Source: Author's computation with the use of E-views9

The estimated parsimonious ECM result reported in table 4.4 above shows the short-run dynamic explanatory variables. The current value of GCE and its lagged value GCE (-4) were both negatively signed and statistically significant to RGDP in Nigeria. This implies that GCE is inversely related to RGDP both in short run as indicated by GCE (-4) and in the long run as indicated by current GCE. Current value of GRE and the lagged values of GRE (-2), GRE (-3) and GRE (-4) were all positively signed as shown by their respective coefficients and statistically significant to RGDP implying that GRE is positively related to RGDP both in the long run as indicated by GRE and in the short run as indicated by all the lagged values of GRE. Both the current values of CPS and the lagged value of CPS (-2) were all negatively signed and statistically significant to RGDP revealing that there is inverse relationship between CPS and RGDP both in the short run as indicated by CPS (-2) and in the long run as indicated by current CPS. However, the ECM coefficient was found to possess the expected sign and significant at 5% but with very low value of approximately 3% speed of convergence to equilibrium in the long run. This is indicative that short run disequilibrium in the model is reconciled overtime. Evidence of the significance of the entire model is provided by the F-statistic while the coefficient of determination (R2) shows that the model was well fitted with the explanatory variables jointly explaining 83% variations in RGDP. Besides, the residual term is not serially correlated given that the computed Durbin-Watson statistic is more than the upper critical value. It therefore follows that the model is free from autocorrelation thereby making our model appropriate for policy prediction.

Policy Recommendations

Following the findings of this research, the following recommendations are preferred:

(i) The government should re-evaluate her capital expenditure component to ensure that funds are utilized on projects with socio-economic impact on the economy, eliminated leakages associated

with misappropriation and embezzlement as well as adequacy of funds on capital project in the right proportion in line with global best practices.

(ii) The government should thrive to establish a balance between her recurrent expenditure and capital expenditure by adopting the Public Private Partnership (PPP) framework in the provision certain social services and infrastructure such as in transportation, energy and railways to reduce the current size of recurrent expenditure.

(iii) Government should adopt deliberate monetary and fiscal policies that would increase private sector access to credit and stimulate the economy such as the use of reserve requirements in place of treasury bills and bonds to reduce the crowding out effect on private sector investment.

CONCLUSION

In this research work, we have empirically verified and discussed the impact of government expenditure on economic growth in Nigeria. From our data analysis in the preceding chapter, which revealed that the current value of GCE and its lagged value GCE (-4) were both negatively signed and statistically significant to RGDP in Nigeria. This implies that GCE is inversely related to RGDP both in short run as indicated by GCE (-4) and in the long run as indicated by current GCE. Current value of GRE and the lagged values of GRE (-2), GRE (-3) and GRE (-4) were all positively signed as shown by their respective coefficients and statistically significant to RGDP implying that GRE is positively related to RGDP both in the long run as indicated by GRE and in the short run as indicated by all the lagged values of GRE. Both the current values of CPS and the lagged value of CPS (-2) were all negatively signed and statistically significant to RGDP revealing that there is inverse relationship between CPS and RGDP both in the short run as indicated by CPS (-2) and in the long run as indicated by current CPS. However, with a low ECM (-1) of approximately 3% speed of convergence to equilibrium in the long run, it is clear that the short run dynamic disequilibrium is slow and statistically insignificant to converging to long run equilibrium, implying that short run government expenditures have no long run impact on economic growth in Nigeria.

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