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Government Spending and Economic Growth in Nigeria: Evidence from Disaggregated Analysis

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The uncorrelated level of economic prosperity with the vast amount of budgetary allocations in terms of expenditure in Nigeria has raised major concerns and occupies the centre of literature debate over time. The dilapidated state of social and human capital in the economy despite its large foreign earnings and expended periodic expenditure over the last three decades has accentuated the need for a theoretical and empirical explanation for the retrogressive advancement of the Nigerian economy. Based on this, the study attempts to investigate the impact of both government recurrent and capital expenditure on growth performance using an econometric analysis based on Johansen technique for the period of 1970-2009. The study found the component of total expenditure impacting negatively (except education and health) and insignificantly on growth rate; further diagnosis test reveals capital expenditure may likely induce significant impact on growth rate in the long-run. Notable recommendations include, proper management of capital and recurrent expenditure, proper surveillance and quantification of capital spending in order to boost social and human capital, and development of sound institutions void of political influences.

Introduction

The direction and magnitude of relationship between government expenditure and economic growth has continued to generate series of debate among scholars. It is obviously presumed that Government performs two basic functions- protection (and 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, and power, etc. are goods provided by government.(ref) many scholars have supported the fact that increase in government expenditure on socio-economic and physical infrastructures encourages economic growth. For instance, studies conducted by Abu N and Abullahi U, 2010, Al-Yousif Y, 2000, Abdullah HA, 2000 and Cooray A, 2009 all concluded that expansion of government expenditure induce economic growth positively. Their studies simply suggest that government expenditure on health and education raises the productivity of labor 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 (Abu N et al 2010).

It has been the desire of nations from all over the world to improve the welfare of their people and give them the power not only to afford the basic necessities of life, but also to empower them to be economically useful to their nations. It is the quest to achieve these that nations are stimulated to increase their Gross Domestic Products (GDP), achieve balance of payment equilibrium, achieve price stability, and increase business activities. Thus, economies are working towards achieving economic growth. Beyond this, they are working towards achieving economic development which does not only involve economic growth, but also transformational changes that accelerate the pace of growth. Though, these are goals, not all nations have been able to achieve them. This is why nations are still classified into the categories of underdeveloped, developing, emerging and developed. Irrespective of each nation's category, each has to work towards survival and sustainability by pursuing the goal of economic growth and development

If the goal of economic growth and development will be achieved, appropriate measures will have to be taken. Various economists have come up with various theories and postulations in this regard. Adam Smith postulated a laissez-faire system such that the government should not intervene to allow the market system free access to pursue surplus value, which according to him, will lead to the wealth of nations (McCreadie, 2009). Classicalists and neo-classicalists still hold this view. On the contrary, Keynes (1936) came up with a postulation that faulted Adam Smith's postulation. In his view, the government cannot hands-off out-rightly, as the market has failure tendencies that are costly. He therefore postulated that the government should be involved by increasing government expenditure to stimulate aggregate demand, which will culminate in economic growth. These two postulations have governed the process of economic development till date; and the strength of each has been tested overtime.

If the market be made solely responsible for the allocation of resources, as advocated by Smith, circumstances will emerge where the pursuit of private interest will not lead to the efficient employment of resources; neither will there be fair distribution. At such point, it is considered that the market failed. Government intervention is thus the way out. The government has to increase its expenditure to stimulate aggregate demand to restore the economy and improve economic growth (Keynes, 1936). The question however is what size of government affects economic growth. Many studies postulate that countries with more growth had large government sizes while those with less growth had smaller government sizes. Knoop (1999) found out from his study that reducing the size of the government reduces economic welfare and growth. But this does not hold in all cases as other studies have come up with contrary results.

Another strand of literature emphasized the effectiveness of government, in order to sustain interest and power; government sometimes increase expenditure and investment in unproductive projects (white elephant) or goods that can better (efficiently) produced by the private sectors. These irrational activities often produce misallocation of resources and impede the growth of national output. The studies conducted by Laudan D, 1986, Barro R, 1991, Engen EM, Skinner J, Folster S, Henrekson M, 2001 asserted that increasing government expenditure may slowdown overall performance of the economy. That is, financing government increasing expenditure by raising taxes or borrowing may induce long-run adverse effects, as higher taxes discourages innovation which in-turn results in lower income and aggregate demand. Likewise, if government finances her expenditure by domestic borrowing, it may crowd-out private investors hereby militating the level of growth.

Available statistics show that total government spending has continued to rise steadily all through the year observed. Following the work of Desmond N.I et al (2012); the government capital expenditure on economic services, social and community services, and transfers increased from N15.5M, N1.4M and N100.7M in 1970 to N809120.5M, N120049.2M and N211758.1M in 2009 respectively. Likewise the recurrent expenditure

has witnessed the same upward trend from N25.95M, N43.55M and N511.42M in 1970 to N340193.77M, N346071.95M and N622171.10M respectively in 2009. The total government recurrent expenditure has consistently been on the increase with about 18% rise from 1970-1985 and about 10% increases from 1990-2005; in the same manner the capital expenditure has maintained similar upward trend (see figure 1). Whether this continuous increase has accentuated the level of growth of the Nigerian economy has necessitated the need for this research work. This necessitates the research interest for empirical quantitative measure of effect of government spending on growth of the economy.
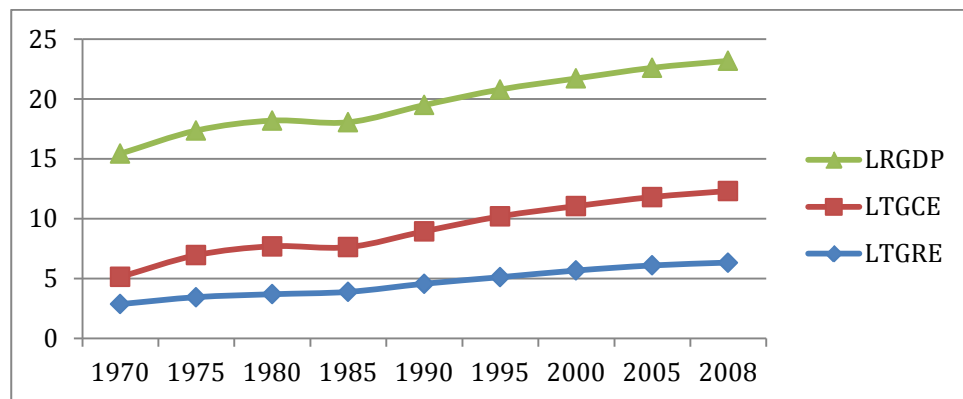

Figure 1: log trend values of RGDP, TGCE and TGRE

This paper seeks to examine the long-run direction of relationship between growth level and the components of the huge and increasing government on capital and recurrent expenditure Nigeria using a co-integration technique over a sample period of 1970-2010.

Literature Review and Theoretical Framework

This section addresses the pertinent literatures and theoretical framework as relevant to the linkage between government expenditure and economic growth. The relationship between government spending and economic development, thus, has been a controversial issue as it has led to the establishment of two positions. One position says that more government spending spurs economic development while the other states that a negative relationship exists between government spending and economic development. Various studies, which are reviewed in this section, have supported these two positions. According to the Keynesian model, increase in government expenditure leads to higher growth while the neo-classical came forth with an opposing view that fiscal policy does not have any effect on the growth of national output. However, recent literature has argued that government fiscal policy mitigate against failure arising from market inefficiencies (Abu N et al 2010). The works of Barro R, 1990 investigated and found that government expenditure (fiscal policy) impacts economic growth; also a corollary studies by Barro R, Sala-i-Martin X, 1992, Easterly W, Rebelo S, 1993, and Barons M, de Groot HLF, Nijkamp P, 1999 supported that government activity determine the direction of economic growth likewise Dar Atul A, Amirkhilkhali S, 2002 supported the relevance of fiscal policy in influencing economic growth.

Yasin (2000) in trying to find a conclusive position examined the effect of government spending on economic growth using panel data set from Sub-Saharan Africa. The results he got by employing Fixed and Random estimation techniques indicated that government spending had positive and significant effect on economic growth. By nurturing productive activities, reducing unproductive ones and implementing

appropriate policies, the relationship between government spending and economic growth can be maintained in the positive direction. This is reflected in Kelly's (1997) study. It was found out from the study of 73 countries over the period 1970-1989 that the contribution of public investment and social expenditures to growth has a positive effect on economic growth. In a study of the Greek economy, Alexiou (2007) reported a positive association between government spending and economic growth; thus, further supporting increase in government spending. The result from Alexiou (2009) gave further evidence when he applied two different panel data methodologies to seven transition economies in South Eastern Europe. The result showed that government spending had significant and positive relationship with economic growth.

On the other hand, Fosler and Henrekson (2001) conducted a panel study over a period of 26 years to discover the relationships that exist between public expenditure and economic development. His empirical findings support the position that large public spending affects growth negatively. The studies of Pevcin (2003), Brady (2007), Pham (2009) and Maku (2009) further support this position. These results, hence, postulate that it is detrimental to increase government expenditure owing to its effect on growth.

It is predicted from mainstream theory that a negative effect is expected in economies where government size exceeds a certain threshold. Thus, there is an optimal size of government above which growth will start to decline. Pevcin's (2003) panel data estimates of Armey Curve, using a sample of 12 European countries, suggests that optimal government size is approximately between 36% and 42% of GDP. This may not be in other countries. But what if the reason for the negative relationship is not increase in government expenditure in itself? What if the root of the problem is the inability to nurture productive activities, reduce unproductive ones and implement the appropriate policies as stipulated by Kelly (1997)? If that is the case, Keynes (1936) may be right after all in all cases. All that is just required is for such government spending to be channeled towards nurturing productive activities and implementing appropriate and rewarding policies.

Besides the kinds of relationship that exist between government spending and economic growth, the question that has come up is which of them causes the other. Keynes (1936) postulated that government spending is the one that causes growth and not otherwise. However, (Wagner, 1958) postulated that it is economic growth that determines government size. Olugbenga and Owoye (2007) in their study of a group of 30 OECD countries during the period of 36 years found out a unidirectional causality from government spending to economic growth for 16 of the countries, while causality runs for 10 countries from economic growth to government spending. Thus, result for 16 countries supported Keynes hypothesis, 10 supported Wagner's law and the rest 4 countries had a feedback relationship between government spending and economic growth. Liu, Hsu, and Younis (2008) examined the causal relationship between economic growth and government spending for US data to further clarify which of them causes the other. Their result further supports Keynes' postulation. Thus, in the US, Keynes postulation has a stronger position than Wagner's. With respect to ECOWAS countries Iyare, Lorde and Francis (2005) and Oteng-Abayie and Frimpong (2009) found no long run causal relationship between government expenditure and economic growth. Oteng-Abayie (2011) thus revisited the issue using an expanded data covering five ECOWAS member countries, as against three by Oteng-Abayie and Frimpong (2009). His result however showed that there is no long run relationship between government expenditure and economic growth in the five ECOWAS Countries (Gambia, Ghana, Guinea, Sierra Leone and Nigeria) covering from 1986 to 2004. This study will therefore revisit this issue by using an expanded data set covering the 14 ECOWAS Countries. The objective of this study, therefore, is to investigate whether a long run relationship exists between government spending and economic growth in ECOWAS Countries.

Model

In studying the relationship between government size and economic growth, Ram (1986) estimated growth equations using data from 115 countries covering the period 1960 - 1980. In his study an equation was derived for economic growth from two separate production functions—one for the government sector and the other for the non-government sector. His result shows that the overall impact of government spending on growth is positive. This contradicts Landau's (1986) findings. Landau (1986) assessed the impact of government expenditure variables on the rate of economic growth using a regression model within the framework of a pooled cross section and time series. He concluded that government consumption expenditure reduced economic growth. It is however noted that Ram's model has a better theoretical foundation (Rao, 1989). Hence, more studies embrace Ram's model more (Maku, 2009). This study therefore adopts Ram's model.

Ram (1986) employed the following two-sector production function framework as follows:

$$C = C(L_c, K_c, G) \qquad (1)$$

$$G = G(L_g, K_g) \qquad (2)$$

Where, C=Non-government sector output, G=Government sector output L=Labor input, K=Capital input

The lower case subscripts indicate the two sectors. The total national output is thus defined as

$$Y = C + G \qquad (3)$$

Part of Ram's (1986) assumption was that marginal productivities of labor and capital in the government sector are (1+δ) times the corresponding factor productivities in the private sector (Rao, 1989). Thus, after taking the total differentials for C and G, it is presented as,

$$dY = C_K dK + C_L dL + \left(\frac{\delta}{1+\delta}\right) dG + C_G dG \qquad (4)$$

Where C_K, C_L, and C_G refer to the marginal productivities in the private sector (Rao, 1989).

Given that, $\beta_1 = C_K$, $\beta_2 = \frac{C_L}{Y/L}$, and $I = dK$, where I connotes investment, equation (4) can be re-written as

$$\frac{dY}{Y} = \beta_1 \frac{I}{Y} + \beta_2 \frac{dL}{L} + \left(\frac{\delta}{1+\delta} + C_G\right)\left(\frac{dG}{G}\right)\left(\frac{G}{Y}\right) \qquad (5)$$

Assuming that $\beta_2 = C_G \left(\frac{G}{C}\right)$ and $\left(\frac{\delta}{1+\delta}\right) = \beta_3$, the following simpler equation is obtained:

$$\frac{dY}{Y} = \beta_1 \frac{I}{Y} + \beta_2 \frac{dL}{L} + \beta_3 \left(\frac{dG}{G}\right) \qquad (6)$$

Econometrically, the model is presented as follows:

$$\frac{dY}{Y} = \beta_0 + \beta_1 \frac{I}{Y} + \beta_2 \frac{dL}{L} + \beta_3 \left(\frac{dG}{G}\right) + \varepsilon \qquad (7)$$

Time series data is limited for some of the variables. Thus, proxies are used. For instance, data has not been found, hence for the purpose of this work, the following model is deemed fit.

$$LRGDP = \beta_0 + \beta_1 LADM + \beta_2 LES + \beta_3 LSCS + \beta_4 LTRFS + e \qquad (8)$$

Where, $LRGD$ is the log of real growth rate, $LADM$ is the log of government spending on administration, LES is the log of government spending on Economic Services, $LSCS$ is the log of government spending on Social and Community Services and $LTRFS$ is the log of Government spending on transfers.

According to theoretical and empirical evidences, government investment spending and government human capital spending are expected to affect economic growth positively. However, government consumption spending (G) is expected to retard growth.

Data Source and Empirical Result

The study has drawn its data from the Central Bank of Nigeria Statistical Bulletin, spanning

from 1970 to 2009. This data is used in econometric analysis to ascertain the effect of government expenditure on economic growth rate in Nigeria.

Table 1: Data Description and sources

Variable	Description	Source
LRGDP	Log of monetary Value of goods and services produced within a country over a period of time, adjusted for price level changes.	CBN, Statistical Bulletin
LADM	Log of the value of government spending on administration, which comprises spending on general administration, defense and internal security, internal security and national assembly.	CBN, Statistical Bulletin
LES	Log of the value of government spending on Economic services comprising agriculture, construction, transport and communication and other economic services.	CBN, Statistical Bulletin
LSCS	Log of the value of government spending on social and community services comprising basically education and health.	CBN, Statistical Bulletin
LTRFS	Log of the value of government spending on transfers comprising public debt servicing, pensions and gratuities, contingencies/subventions	CBN, Statistical Bulletin

Source: compiled by the authors

Estimation Procedure

Unit Root Test

The study attempted to examine the integration order of each variable used in the empirical models; a necessary but not a sufficient condition is for each variable to be integrated of the same order, which must be greater than zero (Olayiwola W.K and Rutaihwa J.L., 2010). Both Augmented Dicky fuller (ADF) and Philip Perron (PP) unit root test of stationarity were applied to achieve this. The unit root test controls for possible serial correlation in error terms by adding the lagged difference terms of the regressand, hereby ensuring that a constant mean and variance exist in the series. This process is pertinent in ensuring that a unit root does not exist in the series, which if existed can lead to a spurious regression and thereby invalid for policy recommendation. The table 2 figures show that each series is first difference stationary at one percent using both ADF and PP test except for the LTRFS which became stationary at 10 percent using the ADF test, since the results are impressive, ADF test is used for co-integration test.

Table 2: Unit Root Results

UNIT ROOT TEST: Reccurent Expenditure				
variables	Level		First Difference	
	ADF	PP	ADF	PP
LRGDP	-2.27696	-5.679612*	-5.360626*	-5.697863*
LADM	0.520989	0.153610	-5.949895*	-8.755866*
LES	0.176903	1.776041	-7.573644*	-12.88898*
LSCS	-0.352386	0.577592	-7.395117*	-17.98634*
LTRFS	-0.427145	-0.274032	-7.786933*	-7.863160*
Critical 1%	-3.621023	-3.621023	-3.621023	-3.621023
Values 5%	-2.943427	-2.943427	-2.943427	-2.943427

		Level		First Difference	
		ADF	PP	ADF	PP
LRGDP		-2.276964	-5.360626	-5.679612*	-5.697863*
LADM		-0.465162	-0.432691	-9.216758*	-8.926961*
LES		-1.941160	-1.873962	-5.976278*	-5.979899*
LSCS		-1.995458	-2.878173***	-7.890473*	-7.854410*
LTRFS		-0.584779	-2.450211	-2.794311***	-27.81241*
Critical	1%	-3.621023	-3.621023	-3.621023	-3.621023
Values	5%	-2.943427	-2.943427	-2.943427	-2.943427
	10%	-2.610263	-2.610263	-2.610263	-2.610263

(Row above table header, continued from previous page: "10% -2.610263 -2.610263 -2.610263 -2.610263" under heading "UNIT ROOT TEST: Capital Expenditure")

Source: computed by the authors

Testing for Co-integration using Johansen approach

The main theoretical argument of co-integration analysis is that even if individual variable is non-stationary, the group of variables may drift together. This suggests that a linear combination of two or more can be stationary, even if are not individually. Since the variables under study are integrated at the same order, there is the need to test for co-integration relationships using Johansen approach. This approach is preferred to the Engle and Granger two step procedure because the later conceals information on the coefficients of the explanatory variables in the co-integrating vector, hence makes it in appropriate for this study. Using this approach, the result was found to be sensitive to the lag length used. The Akaike information criterion is used in selecting lag length to be included in the estimation. The co-integrating tests result of the recurrent expenditure model indicate the existence of a unique co-integrating vector using the maximum eigenvalue (table 3) while the capital expenditure model indicate the existence of a unique co-integrating vector for both maximum eigenvalue test and trace test.

Table 3: Co-integrating Equations

TRACE TEST: Recurrent Expenditure

Eigenvalue	Trace static	5 per cent critical value	Prob**	Hypothesized No. of CE(s)
0.680964	107.2086	88.80380	0.0013	None**
0.536044	66.08030	63.87610	0.0323	At most 1*
0.403774	38.43351	42.91525	0.1307	At most 2
0.288668	19.81662	25.87211	0.2353	At most 3
0.189290	7.554427	12.51798	0.2902	At most 4

MAXIMUM EIGENVALUE: Recurrent Expenditure

Eigenvalue	Trace static	5 per cent critical value	Prob**	Hypothesized No. of CE(s)
0.680964	41.12826	38.33101	0.0233	None**
0.536044	27.64678	32.11832	0.1597	At most 1
0.403774	18.61690	25.82321	0.3318	At most 2
0.288668	12.26219	19.38704	0.3912	At most 3
0.189290	7.554427	12.51798	0.2902	At most 4

TRACE TEST: Capital Expenditure

Eigenvalue	Trace static	5 per cent critical value	Prob**	Hypothesized No. of CE(s)
0.721300	85.55963	76.97277	0.0095	None**
0.462969	42.12059	54.07904	0.3684	At most 1
0.284920	20.98278	35.19275	0.6634	At most 2
0.185655	9.580494	20.26184	0.6809	At most 3
0.073561	2.597858	9.164546	0.6581	At most 4

MAXIMUM EIGENVALUE: Capital Expenditure

Eigenvalue	Trace static	5 per cent critical value	Prob**	Hypothesized No. of CE(s)
0.721300	43.43904	34.80587	0.0037	None**
0.462969	21.13781	28.58808	0.3301	At most 1
0.284920	11.40229	22.29962	0.7125	At most 2
0.185655	6.982636	15.89210	0.6716	At most 3
0.073561	2.597858	9.164546	0.6581	At most 4

Source: computed by the authors

The normalized co-integration results readily available from the Johansen technique (table 4) indicate that the variables LADM, LES, and LTRFS impact a negative and insignificant relations on the growth rate. The variable LSCS which represents the indicator of government recurrent spending on health and education induced a positive relation on growth rate. The magnitude 0.0749 shows a low degree of responsiveness of growth rate to changes in LSCS; that is, government recurrent spending on the education and health does not culminate into growth. The insignificance of LSCS and other recurrent expenditure components show that the growth process of Nigeria over the years observed can't be linked to government spending. Though, considering the magnitude; government total expenditure except Education and Health may slowdown economic growth. These findings may not be unrelated to mismanagement and embellzement of public funds by government and political officers. These findings are consistence with Abu N and Abdullahi U 2010; Laudau D. 1986; Barro R, 1991; Engen EM, Skinner J, 1992; Folster J, Henrekson M, 2001.

The same instance applies to government capital expenditure, the explanatory variables exact a negative impact on growth rate except LSCS. Generally, total components of government spending has not accentuated the growth process of the Nigerian economy.

Table 4 Co-integrating normalized equations

Co-integrating coefficient normalized on growth: Recurrent Expenditure				
LRGDP	LADM	LES	LSCS	LTRFS
1.000000	0.914697	0.349692	-0.074926	0.365457
	(0.20911)	(0.23635)	(0.14610)	(0.23552)
Co-integrating coefficient normalized on growth: Capital Expenditure				
LRGDP	LADM	LES	LSCS	LTRFS
1.000000	1.315188	0.253071	-1.820972	-0.405065
	(0.20016)	(0.19128)	(0.06028)	(0.40516)

Source: computed by the authors

In ascertaining the existence of co-integration, there is need for derivation of the error-correction model from the co-integrating equations by including the lagged error-correction term, this process helps in capturing the long-run information that might have been probably lost during the differencing. For theoretical meaningfulness, the coefficient of the error term should be negative and range between zero and one in absolute term. The error-correction term to be estimated represents the short-run to long-run adjustment equilibrium trends.

The error correction term is the residual from the static long run regression and it joins the set of differenced non-stationary variables to be estimated to capture both short run and long run dynamics. Here, the variables in co-integrated equations are considered as endogenous in the Vector Autoregressive (VAR) model.

Table 5 : Vector Error Correction Models

Vector Error Correction Model for Growth: Recurrent Expenditure				
Variable	D(LRGDP)	D(LADM)	D(LES)	D(LSCS)	D(LTRFS)
ECT_1	-0.010138	0.043939	0.237137	-0.034490	-0.050283
	(0.05503)	(0.05097)	(0.07332)	(0.09033)	(0.04513)
	[-0.18423]	[0.86212]	[3.23436]	[-0.37972]	[-1.11411]
Vector Error Correction Model for Growth: Capital Expenditure				
Variable	D(LRGDP)	D(LADM)	D(LES)	D(LSCS)	D(LTRFS)
ECT_1	-0.509372	-0.182076	-0.158847	-0.004104	0.906802
	(0.19731)	(0.33673)	(0.36595)	(0.44392)	(0.44531)
	[-2.58163]	[-0.54072]	[-0.43406]	[-0.00924]	[2.03634]

Source: computed by the authors

The diagnosis tests performed on various orders of the error correction model indicate that the the capital expenditure model has negative sign; also the magnitude of the error correction term coefficient lies between zero and one. This indicates a 50 per cent short run disequilibrium adjustment to long run equilibrium each year, and the significance of the error correction term obtained from the capital expenditure components shows that the speed of growth to converge to equilibrium path (considering the explained variation by the explanatory variables) is high. But in the case of recurrent expenditure model; the result indicates 1.0 per cent short run disequilibrium adjustment to long run equilibrium each year, and the insignificance of the error correction term obtained from the components of recurrent expenditure shows that there is no speed of convergence. The implication of these findings is that government capital expenditure may likely accentuate the growth process in the long-run than the recurrent expenditure.

Conclusions

The paper investigated the effect of government expenditure (both recurrent and capital) on growth rate in Nigeria using the Johansen co-integration analysis. Evidences from the analysis spanning from 1970-2009 shows that the components of total government expenditure induced a negative (except spending on education and health) and insignificant in explaining the trend of economic growth. Also, the study shows the possibility of long-run equilibrium convergence between the components of capital expenditure and growth while the long-run convergence between the components of recurrent expenditure and economic growth may not be attainable.

To further accentuate the level of growth in Nigeria, the government must ensure proper management of capital and recurrent expenditure in order to enhance productive capacity and accelerate the growth process. A proper surveillance on capital spending is required in order to boost both human and social capital; experiences from the emerging markets sees human capital has widely adjudged as the engine of growth while social capital is the lubricants. Capital spending monitoring and outcome qualification is urgently required as these areas have been grossly neglected, which has resulted in fund misappropriation, white elephant and abandoned projects. Nigerian government should ensure a proactive spending in enhancing the quality of human and social capital. Finally, the government should develop functional and sound institutions; though the Economic and Financial Crime Commission, Independent Corrupt Practices Commission has achieved a measure but there is need to strengthen institutions and ensure that they are devoid of political influences in order to mitigate the incessant diversion and gross embezzlement of public funds.

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