

## **Fiscal Policy Instruments and Economic Growth: Evidence from Nigeria**

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### **ABSTRACT**

*This study was conducted to discover the linkage between fiscal policy instruments and economic growth with special focus on Nigeria for a time frame ranging from 1986 to 2019. Data derived from Central Bank of Nigeria Statistical Bulletin were analyzed using Philips-Perron and Augmented Dickey-Fuller tests. As a result of the outcome of the  $I(0)$  and  $I(1)$  order of integration among the data series, Autoregressive Distributed Lag Approach was utilized to uncover the effects of fiscal policy on economic growth. The findings indicated that fiscal policy growth has potentials to influence economic performance in the long run. It was discovered that government non-oil revenue is the only fiscal policy tool that improve economic performance while oil revenue, external debt and government spending negatively influence economic performance in Nigeria. Conclusively, government fiscal policy which hovers around incremental approach do not improve economic performance. Consequently, there is need for a redirection in fiscal policy frameworks of government towards allocation of more funds to capital and enhancing productive expenditure. Massive restructuring and redirection of the economy of the country towards non-oil sectors like agriculture, mining, micro, small and medium scale enterprises is needed at this auspicious time that oil price and revenue generated therefrom keeps fluctuating.*

**Keywords:** Fiscal policy, economic performance, public spending, government revenue.

### **1. Introduction**

Government of both industrialized and less developed nations have continued to be committed towards the attainment of diverse macroeconomic objectives in order enhance per capita income and welfare of citizens. Therefore, governments globally have focused their attention towards formulation of policies strateged towards the major goals of the nation (Alesina, & Perotti, 1997; Adam, & Bevan, 2003). Fiscal policy which centers on policy frameworks of using taxations, borrowing and public spending to control the level of economic activities is one of the major potent macroeconomic policies that is adopted by government to achieve accelerated growth and development in the economy (Agu, Okwo, Ugwunta & Idika, 2015).

Theoretically, the significant effect of fiscal policy in promoting growth is justified by Keynes who argued that the great depression of 1930 in most countries which led to high unemployment and poverty rate resulted from the failure on the part of government to regulate and control the economy through its spending to provide basic amenities and structural reformations in order to achieve both short run and long run growth (Ardagna, 2004; Samuelson, 2015; Blinder, 2016). Musgrave and Musgrave (1989) supporting the assertion of Keynes, opined that market mechanism which is usually controlled by the



private sector may not operate the economy optimally to actualize the macroeconomic objectives which resulted in the need for government intervention through its policy and structural formworks to moderate the economy.

Since the late 1970s, fiscal policy has become a major instrument in Nigeria due to the dominant role of public sector in the economy. This can be traced to several factors such as oil boom of early 1970s; the need for rebuilding the country after the civil war; industrialization strategies of the country and the centralization of governance (Siyan & Adegioriola, 2015). However, following the return of the country to democracy in 1999, Nigeria's potential for sustainable growth, poverty reduction and welfare enhancement has remained a mirage despite expanding government budget over the years. Government budgetary expansion and expansionary policies are yet to impact the growth of the economy as expected in terms per capita income, gross domestic product and poverty. For instance, total spending of government as a percentage of gross domestic product fell from 2.60 in 2009 to 1.59 in 2010, 1.44% in 2011, 1.20% in 2012 before rising slightly to 1.37% in 2013 (CBN, 2017). The percentage of government total expenditure to gross domestic product fell to 0.87 in 2014, 0.86 in 2015, 0.62 in 2016 before rising to 1.02 in 2017 and later fell to 0.06 in 2018 (CBN, 2018). Despite increase in government expenditure in Nigeria, the nation persistently experience hunger, high poverty, rising unemployment rate, inadequate infrastructural development, divestments and underwhelming economic performance (Igwe, Emmanuel & Ukpere, 2015). These challenges are more pronounce following the distortion and economic shock caused by COVID-19 outbreak which affected world and national economies globally.

However, the linkage among fiscal policy and economic growth has been a subject of high debates in literature. This is because, government's annual budget hovers around fiscal policy stance, and performance of budgetary outcome of government is one of the major determinants of economic activities, investments and overall growth in the long run. While the area of government fiscal responsibility has continually attracted scholars' attention in Nigeria, fiscal policy instruments were not adequately disaggregated in extant literature to reflects the current economic situation of Nigeria (Babalola & Aminu, 2015; Alimi, Yunusa, Akintoye & Aworinde, 2015; Maku, 2015; Adeyemi & Odetayo, 2017; Igwe, *et al.*, 2015 Adeyemi & Odetayo, 2017; Nwakwo, Kalu & Chikezie, 2017; Ndubuisi, 2017). Currently, the Nigeria economy relies heavily on dwindling revenues which are inadequate to support high and incremental expenditure on the path of the government. Study of this nature is important at this peculiar post COVID-19 periods when global economic activities are just picking up from the lockdown occasioned by the COVID-19 outbreak. This article therefore broadly investigated the aftermath of fiscal policy growth on economic growth in Nigeria.

However, the issue of whether fiscal policy influence economic growth in Nigeria has not been laid to rest as a result of the huge government expenditure and insufficient government revenue over the years. The study thus, examined the effect of fiscal policy growth on economic growth in Nigeria taking into consideration the policy thrust of the government to achieve high economic growth. This policy direction has resulted in the expansion of government spending which had eventually led the country to go into borrowing.

## 2. Literature Review

Theories on government role in the economy are embedded on how fiscal policy frameworks operate in the economy and how government are able to control and achieve desired level of economic performance and prosperity (Reem, 2009). In the modern



economy with rising population which brought significant economic and environmental challenges, governments are faced with the option of using macroeconomic policies to solve diverse economic challenges and achieve sustainable long-term growth and development (Ram, 1986).

The celebrated work of Adolph Wagner (1835-1917), showed that increasing public spending is determined by expansion in functions of the state and need for industrialization in modern economy. Also, the theory of Musgrave, suggested that, low per capita income and increase in demands for public goods like health, education and transport will lead to increase in government spending (Barro, 1990 Hoppner & Wesche, 2000). The Keynesian hypothesis asserted that, interventionism is necessary to correct distortions in the market economy, low demands, unemployment and downward trending business cycle (Afonso, 2000). Keynes advocated for the choice of fiscal policy framework to solve the numerous economic challenges that are attached to recession and low economic activities in market economy

Due to the theoretical propositions, extant literature existed globally on fiscal policy linkage with economic growth. Hoppner and Wesche (2000), de Castro and Hernández (2006) observe that government spending had positive effect on growth rate of GDP. Also, Barro and Sala-i-Martin (1992); Kneller, Bleaney and Gemmell (1999); Amanja and Morrissey (2005) established significant effects of fiscal policy instruments on economic growth. However contrary to these results, Landau (1983) found in his cross-sectional data that public consumption is not growth inducing. Similarly, Barro (1990) established that government consumption and public investment did not promote growth.

Bohn (1998); Bravo and Silvestre (2002); Collignon (2012) found high sustainability of fiscal policy in U.S. and European countries while Afonso (2000) showed lack of fiscal sustainability in most European countries. The studies by Ogbale, Amadi and Essi (2011); Oyeleke (2013); Byiabani and Mohseni (2014); Sineviciene and Vasiliauskaite (2012); Maku (2015); Ugwuanyi and Ugwunta (2017); Al-Masaeed and Tsaregorodtsev (2018); Miftari, Kida and Shala (2021); Alzyadat and Al-Nsour (2021) also found that fiscal policy instruments are growth inducing and sustainable in developing countries. Conversely, Oyeleke (2013); Macek and Janku (2014); Abdurrauf (2015); Joel and Onuora (2021); Abada and Manasseh (2020) did not find positive and significant effect of fiscal policy on economic growth.

In *précis*, fiscal policy framework and economic growth nexus has been a subject of high discussion in extant studies. However, the sources through which fiscal policy indices impacts economic growth varies in literature and different kinds of relationship were found in existing studies. However, the current article compliment on past literature by disaggregating fiscal policy tools to reflect the economic structure of Nigeria.

### **3. Methodology**

The data for the article were time series in nature and covered the periods of 1986 to 2019. This period was selected because it reflects trends of growth in government spending and expenditure under diverse economic conditions such as boom and recession. The datasets were sourced from Central Bank of Nigeria Statistical Bulletin (2019). The study followed the empirical model of Hoppner and Wesche (2000), de Castro and Hernández (2006); Alzyadat and Al-Nsour (2021); Miftari, Kida and Shala (2021). However, in this work, fiscal policy tools were disaggregated into five components of government capital expenditure, government recurrent expenditure, government oil revenue, government non-oil revenue and



external debt in order to reflect current budgetary and economic structure of the Nigerian economy while controlling for inflation.

For the purpose of uncovering the effect of fiscal policy instruments on economic growth, a linear regression model was formulated. This is given as:

$$GDP = f(GCE, GRE, GOR, GNOR, INFR)$$

The linear equation of this model can be written as:

$$LGDP_t = \beta_0 + \beta_1 GCEGDP_t + \beta_2 GREGDP_t + \beta_3 GORGDP_t + \beta_4 GNORGDP_t + \beta_5 EDGDP_t + e$$

The model above was reformulated to incorporate interest rate as control variable which is stated in linear form as:

$$LGDP_t = \beta_0 + \beta_1 GCEGDP_t + \beta_2 GREGDP_t + \beta_3 GORGDP_t + \beta_4 GNORGDP_t + \beta_5 EDGDP_t + \beta_4 INR_t + e$$

Where:

LGDP = Log of Gross Domestic Product

GREGDP = Government Recurrent Expenditure to GDP

GCEGDP = Log of Government Capital Expenditure to GDP

GORGDP = Log of Government Oil Revenue to GDP

GNRGDP = Log of Government Nonoil Revenue to GDP

EDGDP = External Debt to GDP

INFR = Inflation Rate

$\beta_0$  = Constant Term

$\beta_1 - \beta_6$  = Parameters of the variables to be estimated

e = Error Term

This analysis procedure for estimating data start with the checking of the time series properties of data series for unit root. This is because a time series data may have mean, variance and covariance that are not constant overtime (non-stationary) and estimation of such data may result in false results (Granger & Newbold, 1974). For this purpose, Augmented-Dick-Fuller (ADF) and Philips-Perron (PP) tests for unit root were employed.

However, following the confirmation that the data series are combination of order I(0) and I(1), the Autoregressive Distributed Lag model (ARDL) for treating data with I(0) and I(1) or purely I(1) proposed by Pesaran and Shin (1999) Pesaran, Shin and Smith (2001) was employed. The process generates the short and long run coefficients of the model in an autoregressive manner. It estimates the short run co-integration and long run coefficients in the model simultaneously and best suitable for data with small sample size, correction for serial correlation and endogeneity (Pesaran & Shin, 1999; Hakkio & Rush, 1995; Dritsakis, 2012). The ARDL model is formulated as follows with Bounds Co-integration as the starting point:



$$\begin{aligned} \Delta LGDP_t = & \alpha_{01} + \beta_1 LGDP_{t-1} + \beta_2 GREGDP_{t-1} + \beta_3 GCEGDP_{t-1} + \beta_4 GORGDP_{t-1} + \beta_5 GNRGDP_{t-1} + \\ & \beta_6 EDGDP_{t-1} + \beta_7 INFR_{t-1} + \sum_{i=1}^q \alpha_{1i} \Delta LGDP_{t-i} + \sum_{i=1}^q \alpha_{2i} \Delta GREGDP_{t-i} + \sum_{i=1}^q \alpha_{3i} \Delta GCEGDP_{t-i} + \\ & \sum_{i=1}^q \alpha_{4i} \Delta GORGDP_{t-i} + \sum_{i=1}^q \alpha_{5i} \Delta GNRGDP_{t-i} + \sum_{i=1}^q \alpha_{6i} \Delta EDGDP_{t-i} + \sum_{i=1}^q \alpha_{7i} \Delta INFR_{t-i} + \varepsilon_t \end{aligned} \quad (3)$$

The short run coefficients of the model is derived through the process and estimation of an ECM given as:  $LGDP_t = \alpha_0 + \sum_{i=1}^p \lambda_{1i} \Delta LGDP_{t-i} + \sum_{i=1}^p \lambda_{2i} \Delta GREGDP_{t-i} + \sum_{i=1}^p \lambda_{3i} \Delta GCEGDP_{t-i} + \sum_{i=1}^p \lambda_{4i} \Delta GORGDP_{t-i} + \sum_{i=1}^p \lambda_{5i} \Delta GNRGDP_{t-i} + \sum_{i=1}^p \lambda_{6i} \Delta EDGDP_{t-i} + \sum_{i=1}^p \lambda_{7i} \Delta INFR_{t-i} + \phi ECT_{t-1} + \mu_t$  (5)

The long run coefficients of the model is formulated as:

$$LGDP_t = \alpha_{01} + \sum_{i=1}^p \Theta_1 GREGDP_{t-i} + \sum_{i=1}^p \Theta_2 GCEGDP_{t-i} + \sum_{i=1}^p \Theta_3 GORGDP_{t-i} + \sum_{i=1}^p \Theta_4 GNRGDP_{t-i} + \sum_{i=1}^p \Theta_5 EDGDP_{t-i} + \sum_{i=1}^p \Theta_6 INFR_{t-i} + e_t \quad (4)$$

Where;  $\Delta$  = differencing,  $ECT_{t-1}$  = error correction term, and  $\phi$  = speed of adjustment.  $\Theta_1 - \Theta_6$ ;  $\lambda_1 - \lambda_7$ ;  $\alpha_1 - \alpha_7$  Parameters.

## 4. Data Analysis and Discussion of Findings

### 4.1 Unit Root Test

Times series economic and financial data are usually characterized by the problem of unit root. As a result of this, data series are checked for possible unit root which many have undesirable outcome from the research. For this reason, Philip Perron and Augmented Dickey-Fuller unit root tests are conducted on the data series to decipher the order of integration of the data series as reported in Table 1 and 2.

The reported result in Table 1 shows that the data series; gross domestic product, government recurrent expenditure to GDP and government nonoil revenue to GDP do not contain unit root at level for both Philips-Perron and Augmented Dickey-Fuller tests at level. However, the data series; government capital expenditure to GDP, government oil revenue to GDP, external debt to GDP and inflation rate contain unit root for Philips-Perron and Augmented Dickey-Fuller tests at first level. Thus, the data series; government capital expenditure to GDP, government oil revenue to GDP, external debt to GDP and inflation rate are check for unit root at level as reported in Table 2.

The results presented in Table 2 suggest that the data series; government capital expenditure to GDP, government oil revenue to GDP, external debt to GDP and inflation rate do not contain unit root for Philips-Perron and Augmented Dickey-Fuller tests at first difference which means that the data series are I(1). Given the outcome of the Philips-Perron and Augmented Dickey-Fuller tests which indicate that data series are process of I(0) and I(1), this study employs the Autoregressive Distributed Lag approach suggested by Pesanra and Shin (1991) for estimating data.



**Table 1: Philips-Perron and Augmented Dickey-Fuller Unit Root Test at Level**

Series	PP Test (Level)	Probability Value	ADF (Level)	Probability Value	Remarks
LGDP	-3.407604	0.0179	-3.970684	0.0044	Stationary
GCEGDP	-2.012250	0.2804	-1.162121	0.6783	Non-stationary
GREGDP	-3.980159	0.0043	-3.990433	0.0042	Stationary
GORGDP	-2.424351	0.1431	-2.349484	0.1634	Non-stationary
GNRGDP	-4.475250	0.0012	-4.501823	0.0011	Stationary
EDGDP	-1.420166	0.5605	-1.159111	0.6800	Non-stationary
INFR	-2.722605	0.0810	-2.568922	0.1094	Non-stationary

**Source: Authors' Computation, 2021**

**Table 2: Philips-Perron and Augmented Dickey-Fuller Unit Root Test at First Difference**

Series	PP Test ( First Difference )	Probability Value	ADF (First Difference)	Probability Value	Remarks
GCEGDP	-8.498356	0.0000	-8.737190	0.0000	Stationary
GORGDP	-7.431909	0.0000	-5.563467	0.0001	Stationary
EGDP	-4.861527	0.0004	-4.864392	0.0004	Stationary
INFR	-5.787537	0.0000	-4.847964	0.0005	Stationary

**Source: Authors' Computation, 2021**

## 4.2 Fiscal Policy Instruments and Economic Growth

### 4.2.1 Selection of Lag

Initiating Autoregressive Distributed Lag method requires that adequate lags are for the model. This is a required procedure for ARDL process so as to ensure that the model does not possess serial correlation and appropriate lags are selected. This is reported in Table 3. The results displayed in Table 3 shows that optimum lag for the estimation of the ARDL method is lag "2" as indicated by all the lag selection criteria. This is because lag "2" shows the lowest values for the lag selection criteria.

**Table 3: Lag Selection Criteria**

VAR Lag Order Selection Criteria						
Endogenous variables: LGDP GCEGDP GREGDP GORGDP GNRGDP EDGDP						
INFR						
Lag	LogL	LR	FPE	AIC	SC	HQ
0	-559.8505	NA	5741104.	35.42816	35.74879	35.53444
1	-373.2910	279.8393	1142.903	26.83069	29.39572	27.68092
2	-250.2827	130.6963*	18.10284*	22.20517*	27.01461*	23.79936*

\* indicates lag order selected by the criterion

**Source: Authors' Computation, 2021**



#### 4.2.2 Long Run Relationship

Estimating the long run relationship among time series data is an important step in ARLD technique and this is achieved with ARDL Bounds Test given in Table 4. The result reported indicates that calculated F-statistic value of 20.24008 is greater than the lower bound value of 2.45 at 5% significance level. This suggests that, disaggregated fiscal policy tools; government capital expenditure to GDP, government oil revenue to GDP, external debt to GDP, government recurrent expenditure to GDP, and government nonoil revenue to GDP have long run relationship with economic performance of Nigeria measures in term of gross domestic product. This implies that, expansion in fiscal policy has the capacity to influence economic performance in the future if fiscal policy frameworks of government are formulated to reflect the realistic situation of the economy. It indicates that fiscal policy tools can be used to moderate the economy and achieve higher economic performance in the long run if properly harnessed and channeled.

**Table 4: ARDL Bounds Test**

Bounds Critical Values	Lower Bound; 1(0)	Upper Bound; 1(1)
10%	2.12	3.23
5%	2.45	3.61
2.5%	2.75	3.99
1%	3.15	4.43
Estimated F-statistic (k=6) = 20.24008**		

**Source: Authors' Computation, 2021**

#### 4.2.3 Short and Long Run Coefficients Model

The results reported in Table 5 shows the ARDL result to uncover the linkage between fiscal policy instruments and economic growth in Nigeria. The short run result under "Panel A" shows that government capital expenditure to GDP produces reducing effect on log of gross domestic product both current period (insignificant) and first period lag (significant). Also, government recurrent expenditure to GDP is established reduce log of gross domestic product both at current period and lag one in the short run. However, government oil revenue to GDP is found to exert positive and significant effect on log of gross domestic product. Furthermore, the short run result reveals that, government nonoil revenue has negative and significant effect on log of gross domestic product but positive and significant effect at lag one. Also, positive and significant linkage is found between external debt to GDP and log of gross domestic product. The control variable, inflation rate has positive and significant effect on log of gross domestic product. Finally, co-integration equation for the model indicates that model respond and adjust to disequilibrium and move towards equilibrium at speed of 5.3%

The long run coefficients reported in "Panel B" of Table 5 reveals that government capital expenditure to GDP has negative and significant relationship with log of gross domestic product which suggest that growth of government capital expenditure reduce economic performance by 0.51%. This implies that government capital expenditure is not large enough to contribute positively to economic performance as paltry amount is being allocated to capital project annually. Similarly, government recurrent expenditure to GDP is established to have negative and insignificant linkage with log of gross domestic product indicating that expansion in recurrent expenditure contract economic performance 5%. This point to the unproductiveness of recurrent expenditure despite increase in allocation to recurrent



responsibilities.

Furthermore, in the long run, government oil revenue to GDP turned out to have negative and insignificant connection with log of gross domestic product which implies that oil revenue produces 5% reduction in economic performance. This largely result from distortion in oil price which lead to fall in proceeds in the recent years. Surprisingly, government nonoil revenue to GDP has positive and significant effect on log of gross domestic product suggesting that expansion in government nonoil revenue will produce 1.3% increase in economic performance. This point to the peculiar benefits of the nonoil sector despite the neglect of the sector with large focus oil sector. Conversely, external debt to GDP is established to have negative and significant effect on log of gross domestic product which shows the unproductiveness of external debt in the long run especially, external debt has grown beyond the capacity of the nation. Finally, the result shows that inflation rate has negative and significant effect on economic performance in the long run.

It was established that government non-oil revenue is the only fiscal policy instrument that improved economic performance while oil revenue, external debt and government expenditures negatively influence economic growth in Nigeria. These findings conformed with the study of Oyeleke (2013); Macek and Janku (2014); Abdurrauf (2015); Joel and Onuora (2021); Abada and Manasseh (2020); Alzyadat and Al-Nsour (2021). The results point to the potentials of the non-oil sectors in Nigeria.

**Table 5: Estimated ARLD Short and Long Run Coefficients Model**

**Dependent Variable: LGDP**

Panel A: Short Run Coefficients				Panel B: Long Run Coefficients			
Variable	Coefficient	t-Statistic	Prob.	Variable	Coefficient	t-Statistic	Prob.
D(GCEGDP)	-0.001181	-0.208111	0.8376	GCEGDP	-0.511936	-4.167052	0.0006
D(GCEGDP(-1))	-0.028023	-3.343202	0.0039	GREGDP	-0.174478	-0.697035	0.4952
D(GREGDP)	-0.020531	-3.702292	0.0018	GORGDP	-0.058751	-1.677192	0.1118
D(GREGDP(-1))	-0.044254	-7.191494	0.0000	GNRGDP	1.390692	4.986104	0.0001
D(GORGDP)	0.005358	2.492807	0.0233	EDGDP	-0.071973	-7.155267	0.0000
D(GNRGDP)	-0.049249	-6.331773	0.0000	INFR	-0.056536	-3.319558	0.0041
D(GNRGDP(-1))	0.033908	7.316671	0.0000	C	1.480232	1.684533	0.1103
D(EDGDP)	0.003848	4.136516	0.0007				
D(INFR)	0.003022	4.030668	0.0009				
CointEq(-1)	-0.053459	-5.005583	0.0001				

**Source: Authors' Computation, 2021.**

### 4.3 Residual Diagnostics Result

Table 6 reports the residuals diagnostic tests for the estimated ARDL model. The findings revealed that the model satisfies all the assumptions of a valid OLS regression. Breusch-Godfrey test shows absence of serial correlation in the regression residuals. Also, Breusch-Pagan-Godfrey test confirmed that residuals are Homoscedatic. Similarly, the Ramsey RESET test, confirmed that the model is appropriately formulated while the Jarque-Bera Normality Test indicated that the residuals are normally distributed



**Table 6: Residual Diagnostics Result**

Diagnostics test	Observed value	P-value
Breusch-Godfrey Serial Correlation LM Test	5.769544	0.0559
Breusch-Pagan-Godfrey test of Heteroskedasticity	14.32479	0.4258
Ramsey RESET test of Omitted Variables	13.76428	0.3160
Jarque-Bera Normality Test	0.266001	0.6131

**Source: Authors' Computation, 2021.**

## 5. Conclusion and Recommendations

Fiscal policy plays important role in any country. It serves as macroeconomic policy framework use by government to control, direct and regulates the economy. Through spending and revenue generated from taxation and other means, government can enhance or contract economic activities depending on the nature of the economy. However, the expansion of government responsibilities must be accompanied by growth in revenue in the budgetary framework to achieve improved economic performance. This paper explored the effect of fiscal policy instruments on the economic growth of Nigeria.

It was discovered that fiscal policy instruments had potential to influence economic growth. Government oil and non-oil revenue and external debt contributed positively to economic performance while government expenditures negatively influenced economic growth. In conclusion, fiscal policy which hovers around incremental approach do not improve economic growth. The hidden meaning of this findings to government and policy makers is that increasing government expenditure which is tailored towards high recurrent spending would not improve economic growth. Thus, there is need for a redirection in fiscal policy frameworks of government towards allocation of more funds to capital and economic enhancing expenditure. Infrastructure investment need to be tailored towards assets that will meet the needs of the manufacturing and productive sector. Massive restructuring and redirection of the nation's economy towards nonoil sectors like agriculture and mining. Promotion of entrepreneurship activities would be beneficial at this auspicious time that oil price and revenue therefrom are fluctuating.

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