



Effects of Fiscal Policy Instruments on Real Sector in Nigeria 1987 - 2019

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ABSTRACT

Fiscal policy is the use of government spending and taxation to influence aggregate demand and the level of economic activities. The main objective of the study is to investigate the effect of fiscal policy on real sector in Nigeria. The specific objectives include to: Investigate the effect of capital expenditure on real sector in Nigeria; Ascertain the effect of recurrent expenditure on real sector in Nigeria; Determine the effect of government borrowing on real sector in Nigeria and evaluate the effect of taxation on real sector in Nigeria. Data for the study were obtained from the Central Bank of Nigeria, Statistical Bulletin, CBN Annual Reports and Statement of Accounts. The data were analyzed with econometric techniques, including Augmented Dickey Fuller Tests for Unit Roots and Ordinary Least Square (OLS) were used. Our findings revealed that capital expenditure, recurrent expenditure and taxation have positive and significant effect on real gross domestic product while government borrowing has negative and insignificant effect on real gross domestic product. The study thus concludes that fiscal policy have positive effect on the real sector in Nigeria and has helped to improve economic growth and development in Nigeria within the period covered by the study. The study recommends that government should use an expansionary fiscal policy to encourage increase in investment in Nigeria. Government spending should be channeled to capital projects and social overhead capital that will encourage investment, such as constant electricity supply and good road networks. Government should rely more on taxation that have greater effects on investment than borrowing. Borrowing should be contemplated only if it is designed to promote the real sector and the amount of debt to borrow should be sustainable to reduce the pressure exerted by its servicing requirements so as to improve the real sector in Nigeria. Borrowing should be contracted solely for economic reasons and not for social or political reasons. To avoid accumulation the incidence of debt-trap and debt unsustainability

Keywords: Fiscal Policy, Real Sector, debt trap, taxation

INTRODUCTION

The real sector is a major segment of the economy because activities in the sector influence economic productivity. It is constituted by economic agents that contribute to a nation's Gross Domestic Product (GDP). The sector is crucial for economic sustainability due to its productive capacity to meet aggregate demand in the economy. The Central Bank of Nigeria (CBN) classifies the real sector in Nigeria into agricultural, industrial, building and construction, wholesale and retail trade and services sectors. The aggregation of production output from these sectors reflects the growth level in the Nigerian economy and can be used as a yardstick to judge economic performance.

Fiscal policy is the use of government spending and taxation to influence aggregate demand and the level of economic activities (Alimi, Yinusa, Akintoye & Aworinde, 2016). Ikeora (2007) defines fiscal policy as the policy of the government which is usually effected through the manipulation of government revenue and expenditure. These are in the form of taxation, government budget (revenue and expenditure), subsidy, planning and direct government investment. The people are to influence economic activities to achieve desirable rational objectives.

These objectives are price stability, income redistribution, employment generations, balance of payment and exchange rate stability and promotion of economic growth and development. The use of government revenue and expenditure to influence macroeconomic variables developed as a result of the great Depression (1929-1930) when the previous laissez-faire approach to economic management became discredited.

The British economist, John Magard, Keynes spearheaded the revolution in economic thinking that overturned the prevailing idea that free markets would automatically provide full employment. The main plank of Keynes theory is the assertion that aggregate demand is the most important driving force in an economy that free markets have no balancing mechanisms that led to full employment and that inadequate overall demand could lead to prolonged periods of high unemployment. Keynes advocated counter cyclical fiscal policies that act against the direction of the business cycle. He advocates fiscal spending on labour intensive infrastructure projects to stimulate employment and stabilize wages during economic cownture, raise taxes to cool the economy and prevent inflation when these is abundant demand side-growth. Keynes argued that governments should solve problems in the short-run rather than wait for the market forces to fix things over the long run because as he put it, "in the long run, we are all dead".

Fiscal policy can be both expansionary and restrictive. A member of empirical findings shows that fiscal policy has a positive effect on the real sector (GDP) (Yinusa, Akintoye, Awaorinde 2016). Studies by Morakinyo, David and Alao (2018) found that fiscal policy has a moderation effect on capital and recurrent expenditure.

Fiscal and monetary policies are the key strategies used by a country's government and Central Bank to advance its economic objectives. While fiscal policy deals with taxation, government spending, subsidy, debt, and budget and are often administered by a government department, monetary policy deals with bank credit, interest rates but both policies influences a country's economic performance. According to Samusi (2010), Nigeria has in the last one decade experienced economic growth but the growth has not been all inclusive, bad based and transformational. The author avers that the major drivers have been the agricultural and service sectors. The use of fiscal policy tools as a measure of achieving growth in the GDP and macroeconomic stability before and after the introduction of the Structural Adjustment Programme (SAP) has not rendered a significant success in Nigeria. This is partly due to the fact that Nigeria's macroeconomic policies have been consistently inconsistent over the past decades. It is against this background that this study attempts to investigate the effect of the fiscal policy instruments on real sector in Nigeria between 1987 and 2018.

Statement of the Problem

Market mechanism cannot solely perform all the economic functions in a country; and as such fiscal policy is required to correct, guide and supplement market forces. Government therefore uses fiscal policies as the mechanism to correct market imperfections and failure. In Nigeria, government at various times had used fiscal policy to manage the economy with a view to achieving desired macroeconomic objectives such as promoting employment generation, ensuring economic stability, maintaining price stability and balance of payment viability, ensuring exchange rate stability and maintaining stable economic growth (Ugwuayi, & Ugwunta, 2017).

Previous attempts to understand the effect of fiscal policy on real sector have resulted in conflicting opinions. The existing studies disagreed both in the line of significance and direction of relationship. A number of the findings suggest significant influence from fiscal policy especially the moderating effect of capital and recurrent expenditure (Miftahu & Rosni, 2017; Morakinyo, David, & Alao, 2018; Apere, 2017; Cynthia, & Itode, 2018; Alimi, Yinusa, Akintoye, & Aworinde, 2016). Despite agreeing that real

sector responds to fiscal policy instruments, these studies are at variance as to the direction of the effect. This conflict suggests that it may not be enough to employ fiscal policy instruments for real sector management. For instance, Cyril, (2016) Ugwuayi & Ugwunta, (2017) and Egbulonu & Amadi, (2016) averred that all the fiscal policy instruments they employed in their studies have a negative effect on the real sector in both the long and short run which implies that capital expenditure, recurrent expenditure and taxation will have negative effect on real sector; as against the belief from studies like Morakinyo, (2018) Sikiru, & Aminu, (2015) Yakubu & Shehu, (2013), which found that fiscal policy instruments promotes real sector. Osinowo, (2015) Shuaib, Augustine, & Frank, (2015), found that capital expenditure, recurrent expenditure and taxation are not statistically significant tools for enhancing real sector.

Different analytical techniques were employed by some of the authors who carried out research in this area. This has contributed to the different results obtained and the conflicts arising there from these shortcomings have created a knowledge gap in the literature. This study will make use of data covering a period of 32 years (1987 to 2019). It will attempt to distinguish between long and short run effects of the variables in the model and determine the causalities among the variables used in the study.

Objectives of the Study

The main objective of the study is to investigate the effect of fiscal policy on real sector in Nigeria. The specific objectives include to:

1. Investigate the effect of capital expenditure on real sector in Nigeria
2. Ascertain the effect of recurrent expenditure on real sector in Nigeria
3. Determine the effect of government borrowing on real sector in Nigeria
4. Evaluate the effect of taxation on real sector in Nigeria

Hypotheses

The following null hypotheses are formulated to guide the study:

- Ho₁: Capital expenditure does not have significant effect on real sector in Nigeria
Ho₂: Recurrent expenditure does not have significant effect on real sector in Nigeria
Ho₃: Government borrowing does not have significant effect on real sector in Nigeria
Ho₄: Taxation does not have significant effect on real sector in Nigeria

REVIEW OF RELATED LITERATURE

Conceptual Framework

Fiscal Policy

Abdurrauf (2015) defines fiscal policy as the process of government management of the economy through the manipulation of its income expenditure and to achieve certain desired macroeconomic objectives. Central Bank of Nigeria (2011) defines fiscal policy as the use of government expenditure and revenue collection through tax and amount of government spending to influence the economy.

Fiscal policy is the means by which the government adjusts its level of spending in order to monitor and influence the nation's economy (Agu & Idike, 2014). It is used along with the monetary policy which the central bank uses to influence money supply in a nation. In other words, fiscal policy is a major economic stabilization weapon that involves measure taken to regulate and control the volume, cost and availability as well as direction of money in an economy to achieve some specified macroeconomic policy objective and to counteract undesirable trends in the Nigerian economy (Abdurrauf, 2015).

Agu, Idike, Okwor and Ugwunta (2014), defines fiscal policy as government's program with respect to the purchase of goods and services and spending on the transfer of payments, and as well the amount and type of taxes. In finance, fiscal policy is the use of government revenue collection (taxation) and expenditure (spending) to influence the economy. The two main instruments of fiscal policy are government taxation and expenditure. Changes in the level and composition of taxation and government spending can affect aggregate demand and the level of economic activity; the pattern of resource allocation; and the distribution of income (Odhiambo., Momanyi, Lucas, & Aila, 2013). This implies that fiscal policy refers to the use of the government budget to influence economic activities. Anthony and

Chukwu, (2015), contends that fiscal policy involves the use of government spending, taxation and borrowing to affect the level and growth of aggregate demand, output and jobs creation. It is the government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy. Fiscal policy is the means by which a government adjusts its levels of spending in order to monitor and influence a nation's economy.

Various researchers have submitted that fiscal policy goals include the following: increasing employment opportunities; attaining full employment; stabilization of domestic prices; promoting economic growth and development through industrialization; achieving equity in income redistribution; achieving stable exchange rate; and increasing the rate of investment in the country (Cynthia, & Itode, 2018).

Capital Expenditure

Capital expenditure refers to the amount spent in the acquisition of fixed (productive) assets (whose useful life extends beyond the accounting or fiscal year), as well as expenditure incurred in the upgrade and improvement of existing fixed assets such as lands, building, roads, machines and equipment, etc., including intangible assets. Expenditure in research also falls within this component of government expenditure. Capital expenditure is usually seen as expenditure creating future benefits, as there could be some lags between when it is incurred and when it takes effect on the economy (Apere, 2017).

One way capital expenditure impacts on economic growth is the creation of employment. The multi-hydra problem of unemployment in the economy is reduced to the barest minimum. Another way it causes economic growth is the re-allocation of resources to every sector of the economy. Resources are moved from the surplus areas to the deficit areas where they are needed with, thus opening up vast opportunities which will improve the citizens of the country (Onyemaechi, 2014).

Recurrent Expenditure

Recurrent expenditure on the other hand refers to expenditure on Purchase of goods and services, wages and salaries, operations as well as current grants and subsidies (usually classified as transfer payments). Recurrent expenditure, excluding transfer payments, is also referred to as government final consumption expenditure. Recurrent expenditures are those incurred on either day to day basis, or weekly, monthly, or even yearly basis and they include administration, internal security expenses, wages and salaries of public workers (Agu, Idike, Okwor & Ugwunta, 2014).

Recurrent expenditures associated with a public investment projects are those operations and maintenance expenditures needed to run the project at a level consistent with its expected use, and to maintain the capacity of the investment during its expected lifetime. For example recurrent expenditures in the case of a new school serving an expanded student population would include the teachers' salaries and additional textbooks and teaching materials required to operate the new facility. They would also include electricity, heating and other costs needed to operate the facility, and the regular and periodic maintenance needed to maintain the facility. Importantly, recurrent expenditures should reflect full capacity utilization of the facility that is, the recurrent expenditures expected when the investment is being used as designed (Akpan, & Abang, 2013).

Recurrent expenditures will be both direct and indirect. Clearly, increasing the number of teachers to staff additional classrooms is a direct cost of investment in improved access to education. Teacher training to supply the necessary teachers may be an indirect cost – unless explicitly provided for as part of the investment project. If possible, indirect recurrent expenditures should be referenced in public investment proposals (Cynthia, & Itode, 2018).

External Debt

Debt is derived from Latin word “debere” meaning to owe. Debt has been conceptualized as resources of money used in an organization which is not contributed by its owners and does not in any other way belong to the shareholders. Okoh (2008) noted that there are two types of debts: domestic debt and external debt. Anyanwu (1999) asserts that when government borrows, the debt is public debt. Public debts may be domestic (internal) or external. Domestic debt is debt incurred by government through borrowing from within the country, while external debt refers to the portion of a country's debt that was

borrowed from foreign lenders including commercial banks, governments or international financial institutions.

Real Sector

The real sector is a major segment of the economy because activities in the sector influence economic productivity. It is constituted by economic agents that contribute to a nation's Gross Domestic Product (GDP). The sector is crucial for economic sustainability due to its productive capacity to meet aggregate demand in the economy. The Central Bank of Nigeria (CBN) classifies the real sector in Nigeria into agricultural, industrial, building and construction, wholesale and retail trade and services sectors. The aggregation of production output from these sectors reflects the growth level in the Nigerian economy and can be used as a yardstick to judge economic performance.

The real sector is a constituent of the economy which consists of individuals and corporate entities that engage in activities aimed at producing goods and services to satisfy public demand. According to Sanusi (2011), the real sector is where production of goods and services take place through the combined use of raw materials and factors of production and it is the driving force of the economy. The output of the real sector indicates the level of productivity in the economy. When the production capacity of the real sector increases, the economy experiences growth. In order to ensure that the real sector operates at its full potential, there must be an efficient financial sector to support it (Sanusi, 2011). The performance of the real sector is a gauge to compare progress between nations.

Theoretical Framework

This study is anchored on the endogenous growth theory. The endogenous growth theory emerged in the 1980s as an alternative to the neoclassical growth theory and was attributed to the work of Paul Rover who was awarded the noble price in economics in 2018 (which he shared with Williams Nordhaus) for his studies on long-term economic growth. According to him, government policies including investment in research and production (S&D) and intellectual property has helped foster endogenous innovations and fuel persistent economic growth. The theory specifically argues that a persistent rate of property is influenced by internal processes such as human capital, investment and investment capital rather than external uncontrollable forces.

The theory assumes that output is a function of capital and labor, while technology is given: $Y = Af(K, L)$, (1) where Y = output, A is technology, being exogenous, while capital (K) and labor (L) are endogenous factors. In the New Growth Model (Endogenous Growth Model) technology is viewed as endogenously determined: $Y = f(K, L, A)$. (2) Technology (A) refers to rate of investment, (K) is the investment in capital stock and (L) is the human capital. This model envisages greater role of government in improving the efficiency or resource allocation and promoting investment to raise the rate of economic growth in developing countries. Government can directly make adequate investment in economic infrastructure such as power, communications, roads, and highways and in human capital, which promote private investment and generate increasing returns to scale. Though, in many respects, endogenous growth is a mere extension of the neoclassical theory of growth. It, however, makes a departure from the neoclassical policy of free market and passive role of government. More specifically, models of the growth effects of fiscal policy are usually built on the basis of Barro and Sala-i-artin (1992) framework. This study draws inspiration from these studies by employing a production function in which government expenditure and taxation enter as inputs. The choice of this framework is owed to its simplicity in application and availability of time series data in Nigeria.

Empirical Review

Morakinyo, David, and Alao (2018) examined the impact of fiscal policy instrument on economic growth in Nigeria using time series annual data from 1981-2014 which constitutes 34 years observations. This study used secondary data obtained from the CBN Annual Statistical Bulletin. Fiscal policy instrument was proxied with government recurrent expenditure, government capital expenditure, public domestic debt, and public external debt while economic growth was proxied with Gross Domestic Product (GDP).

The data were analyzed using Ordinary Least Square method and vector error correction mechanism was conducted. The study found that recurrent expenditure and public domestic debt exert negative relationship while the capital expenditure and external debt exert positive relationship in the long run on the economic growth (GDP) and in the short-run the entire variables are having positive influence except REC (recurrent expenditure) on the economic growth (GDP).

Umeora and Ikeora (2016), Investigate the effect of government fiscal deficits on money supply in Nigeria. The method of analysis is Error Correction Model (ECM) and Pairwise Granger Causality. The regression results show that government fiscal deficits have significant and negative effect on money supply and that inflation does not contribute significantly to money supply and fiscal deficits. Pairwise Granger Causality is that money supply granger cause fiscal deficits. The study recommends that government should fiscal deficits so as to control the level of money supply and subsequently inflation

Omodero, Ihendinihi, Ekwe, and Azubuike (2016) empirically examined the impact of fiscal policy on the economy of Nigeria between 1994 and 2014. Secondary method of data collection was used to generate data for this study and the sources of the data included Annual Reports accounts and CBN Statistical Bulletin (2015). Multiple regression of ordinary least square estimation was the tool used to analyze the data in this study. In the model, real GDP (as dependent variable) was regressed on capital expenditure, recurrent expenditure, tax revenue and external debts. The study has revealed that there exists no significant relationship between capital expenditure, recurrent expenditure, tax revenue and the real GDP representing the economy. However, the study found a significant negative relationship existing between external debts and the real GDP. This supports the Keynesian view of government active intervention in the economy using appropriate various policy instruments.

Ezeabasili, and Egbunike (2014) examined fiscal deficit and private consumption: the Nigerian experience between 1970 to 2006. The study used secondary data obtained from the Central Bank of Nigeria Annual Statistical Bulletin. The data were analyzed using Augmented Dickey Fuller test, Phillips-Perron Test for unit root test, Johansen Multivariate Co-integration Test and Variance Decomposition Error and Impulse Response. The result of the study indicate that the coefficient of the growth of disposable income is positive, indicating a short-run marginal propensity to consume of 1.40, without any adjustment lag. This shows that the pure Ricardian Equivalence hypothesis does not seem to hold in the Nigerian case. Further evidence indicates that government consumption and fiscal deficits have depressive effect on private consumption in Nigeria. Specifically, a 1% increase in fiscal deficit reduces private consumption by 0.2 85% and a 1% increase in government expenditure reduces private consumption by 0.694%.

METHODOLOGY

Research Design

The study adopted an *ex-post facto* research design because the data sourced from Central Bank of Nigeria (CBN), Annual Reports and Statement of Accounts. The data covered the period of 1987 to 2019.

Variables of the Study

Dependent Variable: In this study, Real sector is proxied by Real Gross Domestic Product (RGDP) which is the dependent variable (Y).

Independent Variables: The independent or explanatory variables (X) in this study are capital expenditure; recurrent expenditure, government borrowing and taxation.

Model Specification

The model used for the study is adopted from the work of Alex and Ebieri, (2014) which is stated as follows:

$$RGDP = f(CE, REX, TAX)$$

Where:

RGDP = Real Gross Domestic Product

CE = Capital Expenditure

REP= Recurrent Expenditure
 TAX=Taxation

The Model is modified by the inclusion of government borrowing, thus:

RGDP= f (CEP, REP, TAX, GVB)

$$RGDP = \beta_0 + \beta_1 CEP + \beta_2 REP + \beta_3 TAX + \beta_4 GVB + \mu \dots \dots \dots 1$$

Where:

RGDP = Real Gross Domestic Product

CE P= Capital Expenditure

REP= Recurrent Expenditure

TAX=Taxation

GVB= Government Borrowing

β_0 and μ are the constant and error term respectively while $\beta_1, \beta_2, \beta_3$ and β_4 are the coefficient of capital expenditure, recurrent expenditure, government borrowing and taxation respectively.

Method of Analysis

The data were analyzed with econometric techniques such as Augmented Dickey Fuller Tests for Unit Roots and the Ordinary Least Square (OLS).

DATA ANALYSIS

Table 1: Summary of the Unit Root Result

Variables	T-statistics	Probability	Order of Integration
RGDP	-6.088595	0.0000	1(0)
CE	-3.867397	0.0053	1(0)
REX	-4.619034	0.0010	1(0)
GVB	-5.531824	0.0031	1(0)
TAX	-9.281478	0.0020	1(0)

Source: Computation from E-view Version 9.0

The table above shows that real gross domestic product, Capital expenditure, recurrent expenditure, government borrowing and taxation assume stationarity at levels. This is indicated by the probability value of the test which is below 0.05 levels of significance.

Ordinary Least Square Regressions

Dependent Variable: RGDP

Method: Least Squares

Date: 06/18/20 Time: 12:07

Sample: 1987 2019

Included observations: 32

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.132704	1638155.	2.133487	0.0042
CE	2.351513	9.234924	2.341532	0.0031
REX	3.632565	6.905754	2.523671	0.0012
GVB	-0.213745	9.365032	-1.204520	0.6324
TAX	1.432723	0.099069	2.339468	0.0027
R-squared	0.785124	Mean dependent var		16568137
Adjusted R-squared	0.745634	S.D. dependent var		26065603
S.E. of regression	6263745.	Akaike info criterion		34.25837
Log likelihood	-527.0047	Hannan-Quinn criter.		34.31868
F-statistic	164.1679	Durbin-Watson stat		2.173199
Prob(F-statistic)	0.000340			

Computed by the Authors with E-View 9.0

From the results of the OLS, the constant parameter is positive at 2.132704 this means that if all the independent variables are held constant, RGDP as a dependent variable will grow by 2.132704

Capital Expenditure: The coefficient of (CE) is positive at 2.351513 with t-Statistic of 2.341532 and probability value of 0.0047 which means that capital expenditure has positive and significant effect on real gross domestic product (RGDP), a unit increase in capital expenditure (CE) will cause (RGDP) to increase by 2.660510 units.

Recurrent Expenditure: The coefficient of recurrent expenditure (REX) is positive at 3.632565 with t-Statistic of 2.523671 and probability value of 0.0012 which means that, recurrent expenditure has positive and significant effect on real gross domestic product. A unit increase in recurrent expenditure will lead to a unit increase in (RGDP) by 1.832566

GVB: The coefficient of (GVB) is negative at 0.21345 with t-Statistic of -1.251721 and probability value of 0.6324 indicating that, (GVB) has negative and insignificant effect real gross domestic product. A unit increase in (GVB) will cause real gross domestic product, to decrease by 0.21345 units.

TAX: the coefficient of (Tax) is positive at 1.432723 with t-Statistic of 2.339468 and probability value of 0.0027 showing that, (TAX) has positive and significant effect on real gross domestic product. A unit increase in (TAX) will cause real gross domestic product, to increase by 1.342700 units

The Adjusted R-squared is 0.745634 which means that 75% of total variation in gross real gross domestic product can be explained by the variables, namely CE, REX, GVB and TAX while the remaining 28% is due to other stochastic variables. The Durbin-Watson statistics at (2.173199) showing that the model is free from autocorrelation. The F-statistic is 0.000340 which means that all the explanatory variables in the study have significant effect on gross domestic product within the period under study.

CONCLUSION

The result of the study indicates that capital expenditure, recurrent expenditure and taxation have positive and significant effect on real gross domestic product, while government borrowing has negative and insignificant effect on real gross domestic product. The study thus concludes that selected fiscal policy have positive effect on real gross domestic product in Nigeria and has helped to promote the real sector in Nigeria within the period covered by the study

RECOMMENDATIONS

The study made the following recommendations:

1. Government should increase its spending on roads and other infrastructural facilities in to promote the real sector in Nigeria
2. Government spending should be channeled to capital projects and social overhead capital that will encourage the real sector in Nigeria
3. Borrowing should be contemplated only if it is designed to improve the real sector and the amount of debt to borrow should be sustainable to reduce the pressure exerted by its servicing requirements so as to promote the real sector in Nigeria. Borrowing should be contracted solely for economic reasons and not for social or political reasons. To avoid accumulation the incidence of debt-trap and debt unsustainability
4. Government should rely more on taxation that have greater effects on investment in the real sector than borrowing.

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