THE IMPACT OF GOVERNMENT EXPENDITURE ON ECONOMIC GROWTH AND DEVELOPMENT IN DEVELOPING COUNTRIES: NIGERIA AS A CASE STUDY

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ABSTRACT

This paper assesses how fiscal and monetary policies influence economic growth and development in Nigeria. The essence of the study in to determine the components of government expenditure that enhance growth and development, identify those that do not, and recommend those that should be cut or reduced to the barest minimum. The analytical frame is based on economic models, statistical methods encompassing trends analysis, and simple regression. This study finds no signified relationship between most of the components expenditure, economic growth and development. The estimated result where mixed in particular, some of the variables were weakly significant as a result of none inclusion of effect of environmental impacts. However it provided important clues to the future direction of research.

1.0   INTRODUCTION

There are many irregularities in the country leading to public outcry and there was increasing fraud in government activities resulting from an inappropriate public finance planning and implementation mostly in some of the developing countries. Banks and businesses were collapsing thereby leading to crisis of confidence in internal and external activities in the economy. One of the hills that caused this is corruption, indiscipline, lack of accountability which is the hall marks of our society in developing countries resulting into decrease in growth and development. Evidence from unstable economic is fund in poorest wages and salary structures in the world. The inter-relationship effect is low productivity, avoidable, idle time, leading to loss of trade with advanced countries that have better finished products. The consequential effect is deficit in balance of trade and payment.

Public Finance is to provide information to all arms of government in other to provide useful data as done for the developed nations that transferred Pubic Finance technology to developing countries. However, the public finance technological transfer has not been used in developing countries to develop their economies. One of the assumption might have been due to culture mingled with public finance information made available to policy makers.The realities have been xtrayed by public finance and practices. Thus, Idomen citied the following:

1.   Buchman (1970): public finance studies the economic activity of government as a unit
2.   Musgrave (1993): the complex of problems that centre around the revenue expenditure process of government is referred to traditionally as public finance
3.   Shirras (1969) the study of the principles underlying the spending and raising of funds by public authorities.
4.   Hymann (1993): public finance is the field of economic that studies government activities and alternative means of financing expenditure. As you study public financed, you will learn about the economic basis of government activities. A key objective of the analysis is to understand the impact of expenditure, regulation on taxes and on borrowing to work … and good income.
5.   Mayo (1996) public finance studies objectively the phenomenon of state finance without prior preferences and without wishing to provide duties for political action. The history of public finance is the reflection in the field of taxes, fees, revenue from demands and of public debts, while economic is defined as a branch of social science that is concerned with money… trade activities and industrial systems in a society. It uses scientific approach for developing economic theories.(Kaewsuwen).
6.   The economist need a model to explain economic process (b) to get reality from observed data i.e. an economic issue and (c) assist an economist to measure changes i.e. developing new economic theory. Public finance is to

provide information to an economist hence it is one of the discipline to serve as an economist technologist.

1.2   GROWTH

Economic growth represents the expansion of a country's potential GDP or output. For instance, if the social rate of return on investment exceeds the private return, then tax policies that encourage can raise the growth rate and levels of utility. Growth models that incorporate public services, the optimal tax policy lingers on the characteristic of services.

Economic growth has provided insight into why state growth at different rates over time; and this influence government in her choice of tax rates and expenditure levels that will influence the growth rates. For instance, exponential growth model is used when the rate of increase is proportional to the amount of quality present e.g. tax = y (t) = yo^{ekt} where (t) is the amount present at any time t, yo is the amount present at initial time = o; and the K is constant (k>o) is the growth rate. If a company increase production, tax will increase, it is also useful in studies in population growth known as doubling times with the following equation.

$$T = 1/k \text{ in } 2$$

Where T is the amount of time required for Y to double in size, the constant k(k>o) is the growth rate; and in 2 ≈ 0.6931 also called rule of 70.

Growth means an increase in economic activities. Todaro (1995) citing Kuznets defined a country's economic growth as a long-term rise in capacity to supply increasingly diverse economic goods to its population, this growth capacity based on advancing technology and the institutional and ideological adjustment that it demands.
This paper discuss the roles played by public finance tools in economic growth and development in developing countries using Nigeria as a reference
The broad objective of this paper is the roles of Public Finance in effective economic development and growth.

1.3   INTER-RELATIONSHIP OF GROWTH AND DEVELOPMENT VARIABLES

High rate per capital output resulting from rapidly rising levels of labour productivity and should result in appropriate pay for the work-force. On a comparative note, wage-rates of developing countries, failed to match the level of input.

Secondly, high per capital income in turn generate high levels per consummation but majority of Nigerians have nothing to consume. On related development advancing technology causes scale as production to change in all aspects but reverse are the case in most developing nations.

2.1 LITERATURE REVIEW

Research has shown that as the economy develops, the expenditure of government tends to increase with increase in economic activities. Growth may vary from one country to another. There are three major contributory factors towards the growth in government expenditure.

1. Wagner's law cited in Likita (1999:45-46) states that ``as per capital income of an economy grows, there will be increase in the number of urban centers with the associated social vices such as crime which requires the intervention of the government to maintain law and order and these interventions by the government have lots of implications, leading to the increase in public expenditure in the economy``.

2. This could be analyzed with equation $Y = AK^1\text{-}aG^a$ this according to Barro (1992) implies that the aggregate of public services g can be spread in a non rival manner over all of the n producers. Because of this non rivalry, the marginal product of public services is the effect of change in G aggregate output, Y = y.n. productive efficiency.

Wagner says, (1999:46) that there is a positive relationship between the per capital income of the citizens in a country with government spending such that the income elasticity of government expenditure is always greater than one. However, other researchers have discovered that the relationship is not always certain because there are periods when government expenditure in relations to the national income will decline when the elasticity of income to government expenditure is less than one (inelastic).

3. Rostow – Musgrave model (1999:46) carried out a research on growth of public expenditure and concluded that, at the early stages of economic development, the rate of growth of public expenditure will be very high because government provides the basic infrastructural facilities (social overheads) and most of these projects are capital intensive, therefore, the spending of the government will increase steadily. The investment in education, health, roads, electricity, water supply are necessities that can launch the economy from the practitioner stage to the take off stage of economic development, making government to spend and increasing amount with time in order to develop an egalitarian society. To illustrate, models with varieties of capital goods is related to technological process corresponds to an expansion of the number of capital goods, the production function is $ZY = A.L^a . \sum_1^N (xj)1.a$, o<a<1.

Iyoha (2002:217) in which he postulated five stages of expenditure growth; "traditional society, preconditions for take-off, the take off; the drive to maturity and the eye of high mass consumption."What determines the accepted expenditure growth depends critically on the assumption of the type of economy, i.e. whether it is a free market economy, a mixed economy or a command economy

Samuelson (1995:514) contributed thus "it is a way of separating out contributions of the different trends during observed growth". In this, public expenditure will grow in sympathy to achieve growth in labour (L) and this will involve increase in education expenses; growth in capital (K) all these will come with through savings or borrowings and technological innovation (Tn), therefore Q = F (K,L, Tn).

1.   Peacock – wise man's model (1999), this theory also looked at increasing public expenditure from the social-political perspective. Government expenditure will increase as income increases but because the leaders want re-election into political offices, so more infrastructures must be provided in order to convince the electorate that their interests are being catered for by the people they voted into power.

However, the citizens of the country are less willing to pay tax. The resistance of the care of the government in form of increased spending to avoid social crises in the economy. The resistance to pay tax by the people will make the state to have low revenue hence the cost of proving more facilities is borne by the government, making government expenditure to increase rapidly.

2.2   <u>ECONOMIC DEVELOPMENT AND GROWTH</u>

Development in human society is a one-sided process; this in turn remained the goals of every society at all times. The term 'development' until recently meant growth measured by GNP or rise in per capital income. Yet development is not growth. Perhaps it could be growth coupled with social justice, (Kayode and Oyeranti, 1999:22). Ingham (1993:1803) suggested that development must be understood from two perspectives:

Development implies changes that lead to improvement or progress, it is believed that an economy that raises its per capita level of real income over time without transforming its social and economic structure in unlikely to be perceived as developing. Pearce and Warford (1993:60) defined economic developments as achieving a set of social goals, since goals are bound to change over time, economic development is, to some extent, a process. An economy in the process of economic development is likely to experience a combination of three sets of change;

(i) An advance in utility; a major factor contributing to advance in well being in real income per capita.
(ii) Advances where needed in the realms of education, health and general quality of life, Goulet (1971:10) argued that economic development involves advances in skills, knowledge, capability and choice.
(iii) Self-esteem and Self-respect: A growing sense of independence from domination by others or at times from the state is a major characteristic of an economy that can be said to be developed.

Todaro (1977) perceived development in terms of the reduction or elimination of poverty, inequality and unemployment that is economic in character must involve change in the composition of an economy's outputs and inputs.

2.3   EVALUATION OF EXPENDITURE AND GROWTH

On the whole, the amount spent by the government did not bring economic growth (see table I). Carvins(1993) cited by likita, adjusting terms of trade shock. Nigeria (2002, 2004) "it is supremely implausible that Nigeria did not take sufficient viable projects with returns higher than the rate of interest on foreign assets. From that perspective, investing domestic savings in domestic capital made foreign sense. But did the Nigerian authorities give themselves enough time to fund the right projects and to complement the investment in a reasonable efficient manner? There are strong grounds to suspects that the answer is no. The anxiety was how to dispose of the massive wealth that arose from oil – without putting a conservative policy in place.

Carvins (1993) cited by likita quotes "However, in the years following the second oil shock, the authorities responded with policies that were significantly more in the activities and extravagant than were following the first oil shock'`. Naira generally depreciated on the black market until sometimes during year 2000. It recorded somewhat during the year and much more strongly during 2000 and 2001 as the oil price increased. From early 2000 until the end of 2001, the naira traded at about $1.00 as the oil market softened in 2002, and the inadequacy of the government response became clear, the black market naira depreciated drastically. By the end of 2003 its value had fallen to about $0.25 at that point, the naira was officially priced well above 1.00 and the black market premium reached almost 350 percent (see table 1). This represented a massive vote of no confidence in the government economic policies."

TABLE 1: International Trade and payments, Nigeria 2000 -2004 in billions of dollars.

Year	Trade Balance	Other Current Acct.	Current A/C Balance	Net	Overall Balance
2000	4.07	-2.70	1.37	1.83	3.66
2001	11.11	-6.00	5.1	-0.76	4.69
2002	-0.91	-5.31	-6.22	-0.72	-5.50
2003	2.7	0.53	-7.24	1.65	-5.39
2004	-1.08	-3.26	-4.34	1.37	-2.97

Calculated figures from IMF Various Issues (1988)

TABLE II: Payments in Nigeria, 2006 in millions of naira

Year	Unofficial	Official	Total
2000	58	-	58
2001	708	2,343	3,551
2002	883	1,219	2,102
2003	624	424	1,048
2004	221	246	407
2005	…	454	454
2006	…	1,395	1,395
Total	2,494	6,581	9,075

….Zero or negligible

Calculated figures from IMF Various Issues (1988)

However, governments have always been very careful in planning her expenditure by means of government budgets and National income determination. A simple definition of government budget is defined as a financial statement of government's proposed expenditure and expected revenue during a particular period usually a year. Iyoha (2002:132) also confirmed that "the budget shows, inter alia, the receipts and expenditure of government is, say in a given year using a close economy, mathematical variables as $AD = C + I = G$ where AD is aggregate demand, C is consumption, I is investment and G is government expenditure, clearly, all things being equal, has an expansionary effect on income while a decrease has contractionary effect on income.

The planning (budgeting) process can be surplus or deficit, that is the (BS) budget surplus is $BS = T-G-R$ where T = Tax, G = Government expenditure and R = Transfer payments while BD = Budget Deficits is $BD = - BS = G+R - T$ at low level of income, the budgets is in deficit (i.e. the surplus is negative because GO + RO exceeded income tax collection. $B = \{(G + R (TO - T1)\}$ where B is a measure of the governments budgets on income. An increase in B can be accomplished in government expenditure and vice versa. Also, the budget is used to attain a targeted level of income.

The role of government expenditure in national income cannot be over emphasized,. Government expenditure includes purchases of goods and services as well as on final products plus the cost of living the services of government employees and transferred payments while on the other hand, GNP is a measure of the economy's total output of goods and services. Thus, the first measure is to compare government expenditure with total output. However, government expenditure is well reflected when total taxes are expressed as percentage of GNP. The third measure is the ratios of government derived income to all personal income.

The economic analysis of government expenditure, size and growth in relation to GNP confirmed a steady increase since independence, though growth and expenditure accelerated tremendously in the year 2000 in response to increase in income fluctuation around the trend as a result of instability in government revenue resulting from unpredictability of the world oil market.

TABLE III: TRENDS ANALYSIS USING 1990 AS A BASE YEAR OF FEDERAL GOVERNMENT RECURRENT EXPENDITURE

Year	Total Recurrent Budget in Millions	Trend 1990 as Base Year	Trend Percentage %
1990	27,208.4	-	
1991	25,580.5	-2,805.75	-10.48
1992	36,060.0	+8,851.6	32.53
1993	93,500.5	+66,292.1	243.65
1994	79,200.0	+51,991.6	191.07
1995	109,936.6	+82,728.2	304.05
1996	141,000	+113,791.6	418.22
1997	160,733.2	+133,524.8	490.75
1998	182,542.1	+155,333.7	570.90
1999	221,119.3	+193,910.9	712.69
2000	353,126.5	+325,918.1	1,197.86
2001	579,329.1	+552,120.7	2,029.23
2002	867,336.5	+840,128.1	3,087.75
2003	948,268	+957,059.6	3,517.52
2004	1,062,691.4	+1,035,483.0	3,805.75

Source: Journal of Economic Management (1995) Vol. 2, No 1.

TABLE IV TRENDS ANALYSIS USING 1990 AS A BASE YEAR OF FEDERAL GOVERNMENT CAPITAL EXPENDURES

Year	Total Capital Budget		Trends Percentage
1990	9,005.6	-	-
1991	9,591.1	+535.5	5.91
1992	15,975.3	+6,920.3	76.42
1993	18,600	+9,544.4	105.40
1994	31,000	+21,944.4	242.33
1995	44,559	+35,503.4	392.06
1996	48,000	+38,944.4	430.06
1997	115,990	+106,934.4	1,180.86
1998	185,375	+176,319.4	1,947.07
1999	136,984.2	+127,928.6	1,412.7
2000	311,608.8	+302,533.2	3,341.06
2001	438,869.5	+429,640.9	4,744.5
2002	321,398.1	+312,342.5	3,449.16
2003	241,688.6	+232,633	2,568.94
2004	314,649.6	+305,594	3,374.64

Source: Journal of Economic Management (1995) Vol. 2, No 1.

2.4 Fiscal and Monetary Policies

Public finance information assists economist to redistribute economic policy using fiscal and monetary policies. Economic policy communicates information better when planned income and receipted income are compared as shown in the model Bellow:

ATR = <u>Total Taxes Paid</u>   where ATR is average tax rate

      Value of Tax Base

MTR rate(Marginal tax rate) model showed additional tax collected over and above planned tax at the base level, therefore taxation is one of the instruments of fiscal policy used by government in promoting stability and real growth in the economy. Edosand and Osaze (1998) quotes former Nigeria Head of state who said,

> ``for the past four years, the present Administration has embarked on the use of taxation not only to raise money to run the business of government but as an important fiscal tool for economic development and the alleviation of poverty. Taxation has been used to encourage savings and investment, redistribute income and curb some social ills. Consequently, priority sectors like the export processing zone (EPZ), solid minerals, oil and gas, and manufacturing have received the right doses of tax incentives``.

In arriving at national decisions by economist, open market operation instrument is used from the output received from public financial controller who stands on the sides of how? Economists who is the chief economist researcher and planner, designs economic activities from raw data received from e-government outputs. However, the e-government information in being mixed with the manual information process used in the same ministry.

2.5   Planning and Budgeting

On how to do it and achieve result, these national physical objectives and requirements, government should ensure that:-

> 'Ensure aggregate fiscal discipline In the face of competing demands for limited financial recourses, it is essential to be able to maintain controls over aggregate expenditure in the medium term.

> > - Facilitate Strategic Prioritization of expenditure across programmes and projects. Within the overall resource availability, allocate resources in accordance with policy and social priorities.

> Encourage technical efficiency in the use of budget resources. Once Allocated, ensures that recourses are used effectively and efficiently.Stanforth (2006)

> From the above information discussed so far, a sound financial management system allows a government to make the best use of available resources.

2.6   PUBLIC FINANCE SYSTEM SUSTAINABILITY AND REPORTING

Arguably, Public Service Organization are falling to keep pace with the steady growth of sustainability reporting in the corporate sector, which is aptly defined by CIPFA (2004) (Chattered institute of public finance and accountancy) as

> ``a public account of an organization's sustainability performance achieved through a combination of leadership, strategic partnering, stalk holder engagement, policy outcomes, and management of the organization's impacts on the local environments, social well-being and economic posterity``.

Therefore, sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. Other definitions emphasis not just an efficient allocation resources overtime, but also a fair distribution of resources and opportunities among the present generation and between the future generations, and a scale of economic activity relative to ecological life support systems.

The weaknesses of public finance information, non-inclusion of environmental impacts such as pollution, degradation and eco-systems into their economic forecast for planning the growth and development of the Nation`s economic activities which is an indication of planning with incomplete economic Data. For instance, Lake Chad has stated drying up, and will soon go extinction. Secondly, thousands are suffering from government policy decisions in Niger Delta in Nigeria and the community has no direct benefits from government since the effects of environmental impacts has not been adequately included in the data used for economic planning. Omission of environmental problem in financial data leads to error of accuracy from economists. However, this is a topic of further research.

3.1 Findings and Analysis:

Recurrent budget has a steady growth. The planning consumption was consistent from 1990 to 2004; the growth was increasing with a sudden fall in 1994 and a big save in 1991. Capital expenditure planning was not consistent. It had the highest growth in 2001 followed by 2002, and 2004, 2000, 2003 and up and down in 1998 to 1999, 1997 and constant from 1996 to 19990. In brief, capital expenditure allocation was very poor compared with the growth in population and level of poverty.

The Federal Government approved down-sizing policy in order to reduce recurrent expenditure; but one noticeable thing that happened was increase in salaries of the Government officers throughout the period. It beats one's imagination that despite huge amount of funds allocated to Capital Expenditure such as infrastructural facilities in education sector (UBE) Universal Basic Education projects, road construction and maintenance; there have been little to show for these huge allocations especially in the Southern states of Nigeria.

Federal Government of Nigeria`s capital accumulation was not encouraging while consumption pattern has been consistent throughout. Assuming the Capital Allocation and spending repeated itself like Recurrent Expenditure, this nation should have been better than this.

From the model above, it is clearly seen that the federal government approved budgetary provisions are considered being spent. The authors singled out planned expenditure on education and health to form an opinion on budget performance on all other sectors of the economy. For a country to develop, the total share of 8.7 (7.2 + 1.5) on Education and Health was very insignificant. In fifteen years period selected, the accumulative average was below 20%

The total capital expenditure for Education and Health sector in 1990 was 6.5% (3.7 + 2.8). The budget was designed to promote illiteracy and ill-health among the citizens. The pattern was very poor throughout the fifteen (15) year period selected.

In 1991, when Abacha's administration created additional states, there was a remarkable savings from Recurrent Expenditure while Capital Expenditure increase was under control. However, Recurrent Expenditure has been on the increase rates on a yearly basis. Judging from sharp increases from 1990 to 2004, Government policy of down-sizing or right sizing failed to reduce the expenditure.

However, the capital expenditure trends failed to follow the recurrent expenditure patterns. For instance, 2001 had the highest trend that was a year Federal Government spent or committed so much on Capital projects so as to develop the nation.

The Regression Analysis was run by statistical Package for Social Science (SPSS) which produce the following results:

Regression (single) for Total Recurrent Expenditure

Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	Education		Enter

a. All requested variables entered.
b. Dependent variable: Total Recurrent Expenditure

Model Summary

Model	R	R square	Adjusted R square	Std. Error of The estimate	R square change	F change	df1	df2	Sig. F change
1	.167[a]	.028	.047	369,531.92	0.28	.372	1	13	.552

a. Predictors: (Constant), Education

ANOVA

Model	Sum of Square	df	Mean Square	F	Sig.
1	5.08E+10	1	5.078E+10	.372	.553[a]
Regression	1.78E+12	13	1.366E+11		
Residual	1.83E+12	14			
Total					

a. Predictors: (Constant), Education
b. Dependant Variable: Total Recurrent Expenditure

Coefficients

Model	Unstandardised Coefficient		Standardised Coefficient	t	Sig.	95% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
1		368218.5		.315	.758	-	911591.434
(Constant)	116103.7	44051.453	.167	.610	.553	679383.989	122030.110
						-	
Education	26862.732					68304.646	

a. Dependant Variable: total Recurrent Expenditure

Estimated Regression equation is $Y = a+bx$
Where   Y = Total Recurrent Expenditure
a and b are determinant constants
x = Education as a percentage of Total Recurrent
From the Regression Analysis computed by SPSS, the linear prediction equation of Total
Recurrent Expenditure on Education as a percentage of Total Recurrent Expenditure is
$Y = 116103.7 + 26862.732x$

From the Regression Analysis computed with the aid of SPSS< linear prediction equation of Total Capital Expenditure on Education and Health as a percentage of Total Capital Expenditure is:-

$Y = 67902.258 + (-17390.2x1) + (57049.392x2)$

In our own opinion, Iyoha`s contributions are in line with the opinion of Ajisafe and Folorunso (2001:147) "that relative effectiveness of monetary and fiscal policy on economic activities in Nigeria was determined through integration and policy error on economic activities in Nigeria was determined through integration and error correction modeling techniques … the result of our analysis shows that monetary rather than fiscal policy exerts a greater impact on economic activities in Nigeria. The emphasis on fiscal actions by the government has led to greater distortion in the Nigerian economy."

4.1 SUMMARY AND CONCLUSIONS

This paper establishes Public Finance as a branch of economic with judging from utilization of same economic models for economic growth and development. It is also evidence that most of monetary economic data comes from Public Finance information system and analyze them to predict economic growth and development. ``Nigerian as one of the developing nations had lost a decade of (10) ten years' decades of developing her economy but failed. Dombusch R. (ed) (1993) It seems that no economic principles can improve the lot except a change of culture, improve on discipline, transparence and do away with corruption. In brief, the country's growth is at a decreasing rate judging from the data analysis and non-inclusion of environmental issues has led to possibility of error in economy. Public Finance systems have not lived to expectation because of inaccurate data sent to all policy decision makers. e-Government in developing countries is totally ineffective as a result of equipment meant for cooler nations but installed in tropical countries.

Situations where successes should have been recorded, corruption, cultural background, lack of transparency, poor accountability and probity have marred growth and development. It is evident that data in use have not been updated by environmental analysts; therefore majority of the economic policy decisions need further review.

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