

## THE EFFECT OF FISCAL POLICY ON ECONOMIC GROWTH IN NIGERIA

Ita, Ita Richard, Nkamare, Stephen Ekpo, Emefiele, Charles Chike, Ethelbert Ononiwu and Olugbemi, Modupe Dunsin

Department of Banking and Finance, University of Calabar, E-mail: [nkamares001@gmail.com](mailto:nkamares001@gmail.com)

Received: 5 Sept. 2020; Revised: 5 October 2020; Accepted: 10 Dec. 2020; Online: 28 December 2020

---

### ABSTRACT

The main thrust of this study was to investigate the effect of fiscal policy on economic growth in Nigeria. Five objectives were formulated to guide the study. The objectives investigated the effect of fiscal deficit, government expenditure, government revenue, fixed capital formation, consumption on economic growth in Nigeria. Relevant data for the study was obtained from the Central Bank of Nigeria Statistical Bulletin. Data collected was analyzed and tested using ordinary least square multiple regression statistical technique. Results of the findings revealed that: fiscal deficit exert a significant effect on economic growth in Nigeria, government expenditure has a significant relationship with economic growth in Nigeria, there exist a significant relationship between government revenue, consumption and economic growth in Nigeria, fixed capital formation has a significant effect on economic growth in Nigeria. It was recommended that the government of Nigeria should formulate good fiscal policies that will stimulate economic growth in the country. Also, the excess revenue should be well expended. Finally, revenue generated should be channeled appropriately to priority sectors. In the case of excess revenue, government should ensure that revenue generated is well expended. Revenue generated should be directed to priority sectors

**Keywords:** Fiscal deficit, government expenditure, government revenue, and fixed capital formation on economic growth in Nigeria

---

### INTRODUCTION

The intent of fiscal policy is essentially to stimulate economic and social development by pursuing a policy stance that ensures a sense of balance between taxation, expenditure and borrowing that is consistent with sustainable growth. However, the extent to which fiscal policy engender economic growth, continues to attract theoretical and empirical debate especially in developing countries. In the 1940s, 1950s, and 1960s, many economists and analysts believed that it was

necessary to regulate the economy (Heppke-falk., Tenhofen., Wolf, 2010). When the American Nobel prize-winning economist, Milton Friedman, generally known as a critic of Keynesian economics, said “We are all Keynesians” he was referring to the general acceptance of the view that a government’s budget is much more than just the revenue and expenditure statement of a very large corporation. Hence, the very size of the budget inevitably gives a powerful influence on the size of Gross National Product (GNP) and total increase of employment. Not so many years ago it was generally accepted, and indeed many people still fervently believe, that when appropriately used, fiscal policy can exert a major influence on economic growth in a country (Giavazzi, Tullio & Marco, 2000).

The Great Depression of the 1930s did much to destroy the notion of a self regulating economy. Prices and wages fell; real national income fell by 25 per cent from 1929 to 1933, and unemployment rate was recorded at nearly 25 per cent of the depth of the depression. Economic events have a way of changing economic models, and the great depression inspired John Maynard Keynes to launch a revolution in Macroeconomic thinking. Keynes ridicules the notion of self-regulation economy and stressed that active governmental policies were necessary to assure full employment. In general, Keynes’s theory was that “Demand creates its own supply”. Keynes turned the classical diction upside down. By the judicious use of fiscal policy (and, to a lesser extent, monetary policy), the total demand for goods and services (aggregate demand) by households, businesses, and governments could be manipulated to achieve the twin goal of full employment and price stability (Fernandez de castro & Hernandez de cos, 2006).

Government action is designed to moderate fluctuations in economic activity which are usually assigned to fiscal policy, monetary policy, exchange rate policy, price and income policy, and national debt–management policy. But importance is usually attached to fiscal and monetary policies because the two are powerfully linked. For example, expansionary fiscal policy, aimed at raising the level of aggregate demand, might be accompanied by monetary policy designed to accommodate changes in the demand for transaction and precautionary money balances and hence to stabilize interest rate (Bode., Gerke & Schellhom, 2006).

Also, it is possible for policies to overlap in relation to both their implementation and their operation. Indeed, it is quite possible that the successful outcome of one policy may be frustrated by the side – effects flowing from the operation of another policy. Thus for example, the government running an

expansionary fiscal policy which necessitates large amount of public sector borrowings from the banking sector may be undermined by monetary policy directed towards holding down the rate of growth of the money supply. In Nigeria, fiscal policies are conducted by a special agency for specified aims. It is the Federal Ministry of Finance that formulates and implements fiscal policy subject to approval by the Federal Government. The fiscal policies are then announced by the Head of State or President as part of Annual Budget Speech. Interest in fiscal policy has intensified greatly in recent years for a number of reasons. Firstly, empirical results have proven the weakening of the relationship between money supply and economic activity in recent years. Secondly, by reputation, monetary economists are especially prone to mutually cancelling difference of opinion. Therefore, it is necessary to study the impact of fiscal policy on economic growth in Nigeria, from 1980 to 2008.

In the light of the debate, the question that comes to the fore is what has been the effect of fiscal policy on economic growth in the country over the years? The objective of the present research work therefore, is to contribute to the debate by investigating the effect of fiscal policy on economic growth in Nigeria over the past few decades. The motivation for the work is that, thus far, debate on the efficacy of fiscal policy in stimulating growth seems to have received scanty attention. This research work therefore seeks to contribute to the public discourse on the matter but, from a Nigeria focused empirical effort. Fiscal policy appears to be one of the most important tools government use in the developing countries including Nigeria to promote economic growth. By definition, fiscal policy refers to that “part of government policy concerning the raising of revenue through taxation and other means and deciding on the level and pattern of expenditure for the purpose of influencing economic activities”. Fiscal policy could play a vital role in creating a favourable climate for rapid economic growth in Nigeria, but in assessing this role, one has to match fiscal against the set policy objectives of the government, taking into consideration development and problems in the economy. Over the years, Nigeria has carried out a number of policies including fiscal policy for the purpose of stimulating or promoting economic growth. This study seeks to examine the effect of fiscal policy on the growth of Nigeria economy.

## **LITERATURE REVIEW**

On the theoretical fronts, however, there are two main strands of literature regarding the role fiscal policy play in fostering economic growth. One view is

that government's support for knowledge accumulation, research and development, productive investment, the maintenance of law and order and the provision of other public goods and services can stimulate growth in both the short-run and the long-run (Foster and Henrekson, 2001). On the other hand, there is also the view that governments are inherently bureaucratic and less efficient and as a result they tend to hinder rather than facilitate growth if they get involved in the productive sectors of the economy. Thus government fiscal policy is thought to stifle economic growth by distorting the effect of tax and inefficient government spending. Fundamental to the discussion is the question of representation of fiscal policy. Here, the literature shows that there are different views as to what best variable captures fiscal stance (Blanchard & Perotti, 2002). Out of the three standard fiscal policy variables; spending, taxation and deficits, the literature does not single any one of these as the most representative in terms of fiscal policy. While many papers have made use of tax rates as a proxy for fiscal policy. Yet other researchers have also used government expenditure. Indeed, while some of the scholars have used government expenditure to account for fiscal policy stances. In a study by Ardagna (2001) the authors argue that none of the three policy variables has a robust association with economic growth when examined individually. Afonso and Sousa (2001) suggests that the inadequacy of any one of the identified fiscal policy indicators as pointed by Ardagna (2001) but disputed in the mainstream growth literature due to the inability of any one fiscal policy factor to adequately account for a given fiscal policy position.

When expenditure is considered, it is observed that certain studies have considered aggregate government expenditure as a single variable, others have said that the variable ought to be decomposed into several categories. These categories should then be analyzed separately. What has become increasingly acceptable is the division of government expenditure into investment and consumption. It is reckoned that the former stimulates growth while the latter impedes growth. In recent times however, people have gone a step further to disaggregate consumption into what has been called productive government and unproductive government expenditure. The argument here is that while certain consumption expenditures particularly those on health, education and infrastructure could foster growth other than types of consumption spending. Nonetheless, Zagler and Durnecker (2003) concede that certain public consumptive expenditures may not directly impact on long-term growth, they may have positive welfare implications in the economy, when it comes to research and development (R&D), expenditures provided by the public sector is expected

that R&D spending would stimulate output growth but in the literature the empirical outcomes are not unanimous in that view (Perotti, 2004). On the role of taxation the assertion is that tax induced distortions, affects private agent's allocative decisions unfavorably in terms of factor accumulation and supply and hence may affect growth. This position is due to the assumption that all taxes save lump-sum, taxes are non-neutral and distortionary. There is also debate about taxation as a short-run fiscal policy instrument and its effect on long-term growth (Zagler and Durneker, 2003). Here again, while one group of taxes such as those on savings, R&D, profits, raw capital and labour are deemed to have direct impact on the growth prospects of an economy, all other tax forms are regarded as inconsequential to growth. The net effect of taxes however, is understood to be the difference between the positive effects from productive government spending and the growth distorting (negative) effect of taxation on growth. Indeed there is a vigorous debate when it comes to the decomposition of taxes and how individual tax components impact economic growth (Perotti, 2007). The size of the public debt and its effect on growth is also explained by a number of competing theories. The point here is that when government runs a deficit it tends to draw on resources that the private sector could have used to accumulate private physical capital. If government engages in any spending that is less productive as compared to that of the private sector, then we are faced with an overall negative growth effect. A contrary view is espoused by Jaaskela (2007) and others who take the position that public debt do not necessarily reduce growth. In a study by Roeger and In't (2009), it is observed that none of the three conventional fiscal policy variables on its own adequately captures the fiscal policy stance of any given economy. Consequently, a third-generation strand of the literature on fiscal policy and economic development has emerged to examine at least two fiscal policy variables simultaneously. Some of these studies include, Zagler and Durnker (2001). The literature reviewed, amply demonstrated that no single indicator sufficiently represent fiscal policy stance. The performance of the macroeconomics is a subject that affects virtually all people. Therefore, in this section, various views of the classical, Keynesians, and New Classical economists with respect to fiscal policy and economic growth. Keynesian economics focuses on the rate of spending in the economy. Spending is what pulls forth the output, and thus supports employment and incomes. Keynesian economics emphasizes that if we can understand what determines the level of spending (aggregate demand), we will know what determines the level of employment and production of output and income in the economy. Hoppner, (2001) argued that a natural

place to start a review of the theoretical literature is with Keynesian approach. The simplest Keynesian model assumes price rigidity and excess capacity, so that output is determined by aggregate demand. In this model, a fiscal expansion has a multiplier effect on aggregate demand and output. The Keynesian multiplier exceeds one, it increases with the responsiveness of consumption to current income, and it is larger for a spending increase than for a tax cut. If a spending increase is matched by a tax increase, the resulting “balanced budget multiplier” is exactly one.

### **RESEARCH METHODOLOGY**

Secondary data study design is such an important design that relies on previously collected/generated data. It is often used in exploratory studies, but sometimes also in descriptive and correlation studies. It requires sophisticated quantitative techniques. In this study, the researcher is looking at whether fiscal policy correlates with economic growth in Nigeria with particular reference from 1990 to 2018. Therefore relevant data concerning variables such as Gross domestic product, (GDP), Government revenue, government expenditure, fiscal deficit and others are collected from the relevant government departments, publications and other sources within the time frame. This study design was selected among other research designs because the study requires secondary data. The data were obtained from the following sources, earlier research reports, government publications (example, CBN statistical bulletin), relevant government departments/establishments, such as CBN, Federal Ministry of Finance etc economic journals, mass media with particular reference to research report and internet. The tools for data analysis are simple tabulation of data and regression model. These statistical techniques enable the researcher to present the time series data in a tabula form and infer whether there is a significant relationship between fiscal policy and economic growth over the period under review.

### **MODEL SPECIFICATION**

The first step in any econometric research is the specification of the model which will attempt the measurement of the phenomenon being analyzed; accordingly, we specify a model that captures the relationship between Gross Domestic Product (GDP) and various expressions of fiscal policies. Firstly, it is a common knowledge that there is a positive relationship between Government expenditures over GDP ratio (GOVY) and Government revenue over GDP ratio (REVY) on one hand, and economic growth, on the other hand,

Algebraically,

$$RGDP = f(\text{REVE}, \text{EXPENDI}, \text{GFCF}, \text{CONSUMP}, \text{FISCAL})$$

Where: RGDP = Real gross domestic product in N' million

REVE = Total government revenue in N' million

EXPENDI = Gross Government expenditure in N' million

GFCF = Gross fixed capital formation in N million

CONSUMP = Consumption in N million

FISCAL = Overall fiscal deficit/surplus.

Econometrically,

$$RGDP = \alpha_0 + \alpha_1 \text{REVE} + \alpha_2 \text{EXPENDI} + \alpha_3 \text{GFCF} + \alpha_4 \text{CONSUMP} + \alpha_5 \text{FISCAL} + U_t$$

Where;

$\alpha_1 - \alpha_5$  are assumed positive

$\alpha_0$  = intercept

$\alpha_1 - \alpha_4$  are the regression coefficients.

$U_t$  = error term.

## RESULTS AND DISCUSSION

**Table 1: Regression result of the relationship between real gross domestic product and revenue, fiscal deficit, expenditure, consumption and gross fixed capital formation**

Dependent Variable: LOG(RGDP)

<i>Variable</i>	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-Statistic</i>	<i>Prob.</i>
C	10.18051	0.800643	12.71542	0.0000
LOG(REVE)	0.376543	0.08732	4.312219	0.0032
LOG(EXPENDI)	0.843276	0.249631	3.37809	0.0063
LOG (FISCAL	0.874532	0.321765	2.717921	0.0128
LOG(GFCF)	-0.17164	0.054327	-3.15949	0.0080
LOG(CONSUMP)	-0.03964	0.004372	-9.06587	0.0000
R-squared	0.742817	Mean dependent var		12.55317
Adjusted R-squared	0.683286	S.D. dependent var		0.573449
S.E. of regression	0.370181	Akaike info criterion		1.005934
Sum squared resid	3.288809	Schwarz criterion		1.241675
Log likelihood	-9.586047	F-statistic		30.79809
Durbin-Watson stat	1.231269	Prob(F-statistic)		0.000038

The result in table 1 shows the relationship between the dependent variable real growth domestic product and the revenue, expenditure, fiscal deficit/surplus, gross capital formation, and consumption as the independent variables. The  $R^2$  of 0.74 indicates that about 74 per cent changes in the dependent variable RGDP is caused by changes in the independent variables REVE, EXPENDI, FISCA, GFCF and CONSUMP. This means that about 26 per cent changes in RGDP could be caused by other variables not found in the equation but indicated by the error term. This result also revealed that revenue, expenditure, fiscal deficit/surplus, gross fixed capital formation and consumption are the prime determinants of real gross domestic product of the nation. The Adjusted  $R^2$  of 0.68 implies that the model is 68 per cent goodness fit. The F-ratio of 30.79 which is significant at 0.05 level of significant means that a significant relationship exist between the dependent variable of RGDP and the independent variables of REVE, EXPENDI, FISCAL, GFCF, and CONSUMP. The estimated coefficient for REVE is positive meaning that there exist a direct relationship between revenue and the growth of the economy. This implies that increase in revenue generated will leads to a corresponding increase in real gross domestic product. This result is in order with economic theory. The result is significant at 5 and 10 percent level of significant. The estimated coefficient for expenditure is positive, this means that there exist a direct relationship between increase in expenditure and growth of the economy. This result is in order with economic theory. The result is also statistically significant at both 5 and 10 percent level of significance. Also the estimated coefficient for fiscal deficit/surplus is positive. This means that there is a direct relationship between fiscal deficit/surplus and the growth of the economy. The result is also in line with economic a priori expectation. The result is statistically significant at both 5 and 10 per cent level of significance. The estimated coefficient for gross fixed capital formation and consumption is negative. This implies that there exist an inverse relationship between gross fixed capital formation, consumption and economic growth as measured by GDP. These results are not in line with economic expectation though the results are statistically significant at both 5 and 10 per cent level of significance. The findings of this study revealed that fiscal deficit exert a significant effect on economic growth in Nigeria. The finding of this study revealed that there exist a significant relationship between government expenditure and economic growth. This implies that increase in government expenditure will certainly raised a corresponding increase in economic growth. This finding is also in line with the finding obtained by Ardagna (2001) who in his study found a significant influence of government expenditure on economic



growth. The finding of this study indicated that government revenue significantly influence economic growth in Nigeria. This means that when revenue generated by the government increases the economy will also witness a corresponding increase in growth. This finding is in order with the finding obtained by Blanchard and Perotti (2002) who found a significant relationship between government revenue and economic growth. The authors noted that increase in revenue will stimulate government spending in developing deficit sectors of the economy, thereby increasing economic growth in the country.

The finding of this study revealed that there exist a significant relationship between fixed capital formation and economic growth in Nigeria. The findings also led to the conclusion that there exist a significant relationship between government revenue and economic growth in Nigeria. Consequently, increased in revenue mobilized by the government will readily increase the spending power of the government which in turn stimulate economic growth. Lastly, fixed capital formation has a significant effect on economic growth in Nigeria.

## **CONCLUSION AND RECOMMENDATIONS**

It is concluded that government action is designed to moderate fluctuations in economic activity which are usually assigned to fiscal policy, monetary policy, exchange rate policy, price and income policy, and national debt-management policy. But importance is usually attached to fiscal and monetary policies because the two are powerfully linked. The study recommended that the Nigerian government should draw good fiscal policies that will stimulate economic growth in Nigeria. In the case of excess revenue, government should ensure that revenue generated is well expended. Revenue generated should be directed to priority sectors.

## ***References***

- Afonso, A. and R. M. Sousa (2009). “The Macro economic Effects of Fiscal Policy”. ECB Working Paper Series, No. 991.
- Ardagna, Silva (2001). “Fiscal Policy Composition, Public Debt, and Economic Activity”. *Public Choice*, 109, 301 – 325.
- Blanchard, O. and R. Perotti (2002). “An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Taxes on Out-put”, *Quarterly Journal of Economics* 117(4), 1329-1368.
- Bode, O., Gerke, R. and Schellhom, A. (2006). “Die Wirkung fiskalis-cher Schocks auf das Bruttoinlandsprodukt”, Arbeitspapier 01/2006 des Sachverständigerirats zur Beurteilung der gesamtwirtschaftlichen Entwicklung.

- Fernández de Castro, F. and P. Hernández de Cos (2006). The Economic Effects of Exogenous Fiscal Shocks in Spain. A SVAR Approach”, ECB Working paper Series, No. 647.
- Foster, S. & Henrekson, M. (2001). Growth effects of government expenditure and taxation in rich countries. *European Journal of Political Economy*, 45, 1501-1520.
- Giavazzi, F., Tullio J, and Marco P. (2000). “Searching for Non-Linear Effects of Fiscal Policy: Evidence from Industrial and Developing Countries,” NBER Working Paper No. 7460 (Cambridge, Massachusetts: National Bureau of Economic Research).
- Heppke-Falk, K. H., Tenhofen, J. and Wolff, G. B. (2010). “The macroeconomic Effects of Exogenous Fiscal Policy Shocks in Germany: A Disaggregated SVAR Analysis”, *Journal of Economics and Statistics Jahrbücher für Nationalökonomie und Statistik* 230 (3), 328-55.
- Höppner, F. (2001). “A VAR Analysis of the Effects of Fiscal Policy in Germany”, Institute for International Economics Discussion Paper.
- Jääskelä, J. (2007). “More Potent Monetary Policy? Insights from a, Threshold Model”, Reserve Bank of Australia, *RBA Research Discussion Papers*, 2007-07.
- Perotti, R. (2007). “In Search of the Transmission Mechanism of Fiscal Policy”, *NBER Working Paper*, No. 13143.
- Perotti, R. (2004). “Estimating the Effects of Fiscal Policy in OECD Countries”, *CEPR Discussion Paper Series*, No. 4842.
- Roeger, W. and J. In’t Veld (2009). “Fiscal Policy with Credit Constrained Households”, *European Economy, Economic Papers*. No. 357.
- Zagler, M. & Durnker, G. (2001). Fiscal policy and economic growth. *Journal of Economic Surveys*, 17 (3), 16-36.

**To cite this article:**

Ita, Ita Richard, Nkamare, Stephen Ekpo, Emefiele, Charles Chike, Ethelbert Ononiwu and Olugbemi & Modupe Dunsin. The Effect of Fiscal Policy on Economic Growth in Nigeria. *Global Journal of Accounting and Economy Research*, Vol. 1, No. 2, 2020, pp. 89-98