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Fiscal Policy Instruments and the Nigerian real Sector

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Abstract

Theoretically, the Keynesian's view fiscal policy as a tool to fine-tune aggregate expenditures and protect people from turbulent swing in their well-being. Fiscal policy entails the use of government expenditures and tax policies to stimulate or contract macroeconomic activities. Government intervention through fiscal policy is geared towards the achievement of macroeconomic stability and real growth. The study examined fiscal policy instruments and the Nigerian real sector. The variables of capital expenditure, recurrent expenditure, government borrowing and taxation were regressed on the Nigerian real sector. The study adopted an *ex-post facto* research design because the data for the study are secondary data which were sourced from Central Bank of Nigeria (CBN), Statistical Bulletin and Statement of Accounts, and were analyzed with Ordinary Least Square (OLS). The available evidence showed that capital expenditure, recurrent expenditure and taxation have positively and significantly enhanced the real gross domestic product. Again government borrowing has negatively and insignificantly affected the real gross domestic product. following the available theories, empirical and the result of the analysis, we submit 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. Amongst the recommendations is that borrowing should be contracted solely for economic reasons and not for social or political reasons. Government should use an expansionary fiscal policy to encourage increase in investment in Nigeria.

Key Words: *Fiscal Policy,* capital expenditure, recurrent expenditure, government borrowing, r*eal Sector*

INTRODUCTION

Over the years, the Nigerian Government had adopted various fiscal policy measures to reduce the problem of unemployment, but still the problem has been on the increase. Fiscal policy is best described as taxation and spending policies that the government pursues in an effort to influence the overall state of the economy. Cyril, (2016) defined fiscal policy as the means by which a government adjusts its level of spending in order to monitor and influence a nation's economy. Fiscal policy is based on the theory of a British economist John Maynard Keynes whose theory basically states that governments can influence macroeconomic productivity levels by increasing or decreasing tax levels and public spending. This influence in turn, curbs inflation, increases employment and maintains a healthy value of money. Taxation is one of the primary fiscal policy tools the government has at its disposal to reduce unemployment. High taxes mean consumers

have less disposable income, which results in less consumption. When consumers buy less, less revenue accrues to businesses making them less likely to hire new workers or may even result to laying off workers to reduce cost. Cutting taxes is a common practice which the government uses to induce economic growth and reduce unemployment. Tax cuts put more money into the hands of consumers, which can lead to increased revenue for business and expansion and hiring. Spending on government programmes is another way government can use to influence unemployment. For example, if the government funds new public works or programmes, such as building infrastructures like roads or rail ways, it can create jobs that serve to reduce unemployment and increase disposable income and spending. If such programmes encourage overall economic growth, employment will be enhanced after the projects are completed.

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 use of macroeconomic policy instruments for the attainment of the desired economic growth has been subjected to different economic views. The classical view argued that harmonizing the fiscal and monetary policies would either increase the pace of economic growth or reduce it depending on the direction of the policies, (Blanchard, 2006). For instance, the use of both expansionary fiscal and monetary policies will enhance growth while the use of both contractionary fiscal and monetary policies will deter growth. Meanwhile, the mixture of both policies will make growth unchanged (ISLM relations). The Keynesian view argued that increased government expenditure would lead to increase in growth. Also, the theory argued that a change in money supply must influence or lead to a change in the interest rate; change in interest rate must lead to a change in the level of investment; and the change in the level of investment must have significant effect on national income (Afolabi, 1998). The Neoclassical economists argued that increased in government expenditure has small or little effect on economic growth, (David & Onwa, 2016).

The achievement of macroeconomic goals of full employment, stability of price level, high and sustainable economic growth, and external balance has been a policy priority of every economy whether developed or developing economies (Aliyu, Ndagwakwa, Zirra, Salam and Mohammed 2020). For many developing countries, a large spectrum of public debate on macroeconomic fiscal policy has not only focused on the output growth outcomes of effective fiscal policy, but also on its effectiveness in business cycle stabilization as a fundamental aspect (Akhor, 2014).

Despite the lofty place of fiscal policy in the management of an economy, the Nigeria economy is yet to come on the path of sound growth and development and is still faced with chronic levels of unemployment, rising rate of inflation, dependence on foreign technology, mono cultural foreign exchange earnings from oil and more (Alimi, Yinusa, Akintoye & Aworinde, 2016).

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 taxationwill 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 taxationare 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.

LITERATURE

Fiscal Policy

The term fiscal policy has conventionally been associated with the use of taxation and public expenditure to influence the level of economic activities. Fiscal policy deals with government deliberate actions in spending money and levying taxes with a view to influencing macroeconomic variables in a desired direction. This includes sustainable economic growth, high employment creation and low inflation (Dikeogu & Itode, 2018; Dickson & Presley, 2013).. Thus, fiscal policy aims at stabilizing the economy. Increases in government spending or a reduction in taxes tend to pull the economy out of a recession; while reduced spending or increased taxes slow down a boom (Dornbusch & Fischer, 1990).

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

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. Edame and Okoi, (2015) contended 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.

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.

Fiscal policy is the use of government revenue collection and expenditure to influence the economy. The application of fiscal policy is basically rooted in the budget of the government. The most vital aspect of a public budget is its use as an instrument to manage an economy (Falade & Folorunso, 2015). Fiscal policy is a deliberate action of government which entails government revenue, expenditure, and borrowing to influence the form of economic activities, level of output growth, employment, inflation and employment (Ugwanta, 2014). Faraji and Makame, (2013) supported this assertion that increase in government expenditure fosters real sector. Furthermore, in an attempt to cater for increasing spending, government tends to increase taxation and/or borrowing which might affect her spending behavior. High taxation de-motivates individuals or firms from investment sphere, which in turn reduces income and aggregate demand (Maku, 2015).

Real Sector

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 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.

Theoretical Framework

This study is anchored on the Keynesian Theory. The role of fiscal policy in the achievement of macroeconomic objectives has been extensively dealt with the Keynesian Theory of an activist macroeconomic policy. The Keynesian analysis leads to the conclusion that demand management policies can and should be used to improve real sector output. An activist macroeconomic policy involves setting monetary and fiscal variables in each time period at the values which are thought necessary to achieve the government's objectives. A basic premise of Keynesian economics is that the private sector is inherently unstable. It is subject to frequent and quantitatively important disturbances in the components of aggregate demand. The broad objectives of Keynesian macroeconomic policy are not in dispute, these objectives are full employment, a stable price level, the absence of significant deviations of output from its equilibrium time path, a satisfactory rate of economic growth, an equitable distribution of income, and balance of payment equilibrium.

There exist, however, differing opinions, regarding the priorities accorded to these objectives. In fact, there is an even greater divergence of views on them earns by which such objectives can be actualized. Keynesian. activist policy has come under increasing attack from the monetarist and classical schools, which regard the private sector as inherently stable. They do not deny that random disturbances occur in the private sector but they do not think that these are either large or further amplified by quantifying adjustments. The private sector adjusts via relative price changes to such disturbances quite adequately, so active stabilization policy is not required. Furthermore, it (stabilization policy) may, if implemented increase rather than diminish fluctuations in output and employment. Nevertheless, stabilization policy requires that policy makers can determine feasible targets, have a reasonable knowledge of the workings of instrumental variables and can effectively control the instrumental variables. Keynesian theory posits that removing spending from the economy will reduces level of aggregate demand and stabilizing pries .However, recent researchers have made an impact to the development of fiscal policy and real sector output through their contribution to the theoretical issues on this study.

Empirical Review

Aliyu, Ndagwakwa, Zirra, Salam and Mohammed (2020) examine the impact of fiscal policy on economic performance in Nigeria between 1981 and 2016. Fiscal policy is represented by government total expenditure, government total revenue and direct tax. A model was developed in which economic growth (proxy as economic performance) is expressed as a function of government total expenditure, government total revenue, direct tax, capital (represented as gross capital formation) and labour (represented as employment rate). The study covered a 36-year period ranging from 1981 to 2016. The econometric techniques of Augmented Dickey Fuller test, Cointegration test and Error Correction model estimation. The study revealed that fiscal policy was partially effective on economic growth (surrogate of economic performance) in Nigeria between 1981 and 2016.

Dikeogu and Itode (2018) empirically examined the effect of fiscal policy on macroeconomic performance in Nigeria from 1970 to 2017. Secondary data were sourced from the Central Bank of Nigeria (CBN) Statistical Bulletin (various issues). The study adopts the ARDL, Engle-Granger Co-integration and Error Correction Modeling techniques for the analysis. Data for the empirical analysis were sourced from secondary sources like CBN Statistical Bulletin (Various- Issues). The results of analysis indicated that a long run relationship exists among the variables (i.e. fiscal policy and macroeconomic performance) based on the Bound co-integration test and Engle-Granger co-integration test. Furthermore, the paper revealed that CXP negatively impacted on EGR, RXP and DUM have negative insignificant effect on EGR while TGR has a positive impact on EGR; RXP has a negative insignificant impact on INF, CXP and TGR, DUM has a positive insignificant effect on INF while DUM negatively impacted on INF; the coefficient of past lag (1) of government capital expenditure (CXP) has a positive insignificant effect on UNE while the coefficient of past lag (2) of government capital expenditure (CXP) has a negative insignificant effect on UNE; the coefficient of past lag (1) of government recurrent expenditure (RXP) has a negative insignificant effect on UNE; the coefficient of past lag (2) of tax revenue (TGR) has a negative insignificant effect on UNE; while the coefficient of both current and past lag (2) of DUM has a negative insignificant effect on UNE.

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).

Falade and Folorunsho (2015) examined the relative effectiveness of fiscal and monetary policy instruments on economic growth in Nigeria in order to determine the appropriate mix of both policies. The study employed the error correction mechanism between 1970 and 2013. Real GDP was expressed as a function of money supply, exchange rate, interest rate (monetary policy instruments), government revenue, government expenditure (fiscal policy instruments) gross capital formation and inflation rate (control variables). The results showed that all the fiscal and monetary policy variables attained stationary. The results also showed a long-run relationship among fiscal and monetary variables and economic growth. The study maintained that the current level of exchange rate and its previous level, interest rate and current level of government expenditure and money supply are the suitable appropriate policy mix in promoting economic growth in Nigeria in short-run and long-run.

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 deploy 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%.

Abdulrauf (2015) examined the short and long run impact of fiscal policy on economic development in Nigeria between 1981 and 2013. The study used government recurrent expenditure, government capital expenditure, government investment and tax revenue to indicate fiscal policy. Economic development was proxied by real per capita income. The study employed the vector error correction model. The results revealed that government recurrent expenditure and government investment have significant positive impact on economic development in both the short and long run. Capital expenditure appeared to have a short run positive impact but not in the long run. Tax revenue has negative significant impact in both short and long run. The speed of adjustment to long run equilibrium stood at 115%. Maku (2015) examined the impact of fiscal policy on economic growth in Nigeria between 1970 and 2011. The study employed the Engle-Granger cointegration for long-run relationship, ordinary least square for long run estimate and diagnostic test for consistency of instruments. Economic growth was proxied by real gross domestic product while fiscal balance was used to denote fiscal policy. Macroeconomic indices such as gross capital formation, broad money supply and exchange rate were captured in the study. The results revealed fiscal policy exerted significant positive effect on economic growth, which indicates that appropriate fiscal measures stimulate economic growth in Nigeria. The study maintained that government spending has greater impact on the growth rate of the Nigerian economy.

Oshinowo (2015) broadly examined the effect of fiscal policy on sectorial output growth in Nigeria between 1970 and 2013. The study employed autoregressive distributed lag model and error correction model. The study investigated the effect of total fiscal expenditure on growth on agriculture, manufacturing, building and construction, mining and services sectors. The results showed that total fiscal expenditure have positively contributed to all the sectors‟ output except the agriculture. The finding also shows that manufacturing is positively correlated with all determinant variables while inflation rate is negatively correlated with output growth of all the sectors except agriculture. The study maintained dichotomy between sectorial responses to fiscal policy variables.

Abubakar (2016) investigated the impact of fiscal policy shocks on growth and unemployment in Nigeria between 1981 and

2015. The study employed the structural vector autoregressive methodology coupled with unit root and cointegration tests. The results showed that shock in public expenditure have positive long-lasting effect on output while revenue shock was found to exert a positive effect (lower than that of public expenditure shock) on output. However, the effect of revenue shock on unemployment was found to be negative but short-lived. Odetayo and Adeyemi (2017) examined fiscal policy sustainability and economic growth in Nigeria between 1980 and 2015. The study adopted the error correction model and autoregressive distributed lag model to analyze the effect on government spending and revenue on output growth in Nigeria. It shows that government revenue, government spending and fiscal deficit grew massively within the period considered. The results equally revealed that fiscal policy is weakly sustainable in Nigeria.

METHODOLOGY

Secondary data covering the period of 1987 to 2020 were sourced from the Central Bank of Nigeria Statistical Bulletin, CBN Annual Report and Statement of Accounts. Thus, the study adopted an *ex-post facto* research design. In this study, Real sector is proxied by Real Gross Domestic Product which is the dependent variable. The independent or explanatory variables in this study are capital expenditure; recurrent expenditure, government borrowing and taxation.

Model Specification

The study adopted the model from the work of Onyekachi, (2018) who examined fiscal policy and real sector in Nigeria:

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)

$RGDP = \beta_0 + \beta_1 CEP + \beta_2 REP + \beta_3 TAX + \beta_4 GVB \mu$ - - - -- - -- - 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 β_1, β_2, β_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	-4.188532	0.0120	1(0)
CE	-4.27337	0.0032	1(0)
REX	-3.519013	0.0432	1(0)
GVB	-4.531813	0.0231	1(0)
TAX	-7.281431	0.0041	1(0)

Source: 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: 10/24/21 Time: 12:07
Sample: 1987 2020
Included observations: 33

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		

Source: E-View 9.0

Capital Expenditure: 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, a unit increase in capital expenditure will cause real gross domestic product to increase by 2.660510 units.

Recurrent Expenditure: 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 real gross domestic product by 1.832566

Government Borrowing: Is negative at 0.21345 with t-Statistic of -1.251721 and probability value of 0.6324 indicating that, government borrowing has negative and insignificant effect real gross domestic product. A unit increase in government borrowing will cause real gross domestic product, to decrease by 0.21345 units.

Taxation: Is positive at 1.432723 with t-Statistic of 2.339468 and probability value of 0.0027 showing that taxation has positive and significant effect on real gross domestic product. A unit increase in taxation will cause real gross domestic product, to increase by 1.342700 units

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 thatselected 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. The study therefore, 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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