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Effect of Fiscal Policy on the Real Sector of the Nigerian Economy: A Focus on Government Capital Expenditure and Agricultural Sector Contribution to GDP

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Abstract

Government expenditures play key roles in the operation of all economies. It refers to expenses incurred by the government for the maintenance of itself and provision of public goods, services, and works needed to foster or promote economic growth and improve the welfare of people in the society. This study examined the effect of fiscal policy on real sector growth in Nigeria. Focusing on government capital expenditure and its effect on the growth of the agricultural sector in Nigeria. The study adopted the ex-post facto research design and regression analysis as methodology using ARDL. Descriptive statistics and graphs were also used to complement the regression result. The result from the study found that there is a significant and positive effect of government capital expenditure on the growth of the agricultural sector in Nigeria. The implication of the study is that fiscal policy through government capital expenditure will increase the agricultural sector growth and thereby increases its contributions to the growth of the economy. This means that when there is enough revenue, the government only spends more money on infrastructural development that can help the agriculture sectors to grow by having access to good road and electricity. The result is an indication that government capital spending in Nigeria has been able to spur the economic growth of Nigeria through agricultural sector output. Based on the findings, the study makes the following recommendations; Government of Nigeria should adhere strictly to the implementation of government spending so as to increase the level of real sector development in Nigeria which will have the capacity to stimulate economic growth and create employment.

Keywords: Government Capital Expenditure, Agriculture, Fiscal Policy, Financing, Growth

1. INTRODUCTION

The performance of any economy is determined to a large extent by the level of activities in the real sector of the economy, but the critical role of the fiscal policy in sustaining a vibrant and stable economy through real sector cannot be overlooked. The achievement of macroeconomic goals, namely full employment, the stability of price level, high and sustainable economic growth and external balance through real sector economy, from the time past, has been a policy priority of every government. Almost all economies of the world, irrespective of the state of the

economy (developing or developed), the government intervenes in undertaking fundamental roles of allocation, stabilization, distribution, and regulation especially when the market proves inefficient. The government particularly pursues key macroeconomic objectives such as economic growth and development, full employment, price stability, and poverty reduction through the application of several policies to rejuvenate the real sector of the economy.

Real sector is a term that has been in focus for several years, mainly because of the economic downturn experienced globally in the recent past. Real sector of the economy is a key variable that measures the worth or strength and competitiveness of a country with other countries, and it plays a very important role in stabilizing the country's economy through its contribution to GDP (Akinmulegun, 2014). In Nigeria, issues of real sector development are intricate and reflect a mixture of both domestic and international characteristics. On the domestic front, the real sector comprises of agricultural, manufacturing, building and construction, wholesale and retail and the services sectors, while activities in the international oil market are intertwined with global economic developments. Consequently, the sectoral policy must adequately address issues related to enhancing the capacity of the private sector to drive real sector activities and hence, achieve higher levels of growth (Ubesie, 2016).

Increasing revenue level, especially the oil revenue, is the characteristic phenomenon of the Nigerian budget every year so as to ensure the growth and development of the real sector. The effect of fiscal policy implementation on the real sector of the Nigerian economy has not been as positive as has been expected in recent time. Both fiscal policy implementation and real sector growth are considered to be very significant for economic growth in any nation (Oyeleke and Ajilore, 2014), but studies about their contribution has research gaps, as little attention has been given to the contributions of fiscal policy implementation on real sector of the economy, particularly in Nigeria using agricultural sector and manufacturing sector as real sector.

Despite the emphasis placed on fiscal policy implementation in the management of the economy, the Nigerian economy is yet to come on the path of sound growth and development through real sector growth. This situation has largely been circulated to the entire sectors of the economy (Oyeleke and Ajilore, 2014).

Further, a lot of empirical studies (Arikpo, Ogar, and Ojong (2017); Ubesie (2016); Osinowo (2015); Raymond and Adigwe (2015) and Peter (2015)) have found that real sector of the economy is measured with one variable as well as fiscal policy. In this study, we will decompose the real sector of the economy into two variables (Agricultural sector contribution to GDP and manufacturing sector contribution to GDP). This is necessary because the real sector is referred to as the absence of excessive fluctuations in the macroeconomy such as agricultural sector which are the major measure of real sector growth. Based on this premise, the study is thus designed to investigate the effect of fiscal policy on the real sector of the Nigerian economy. Focusing on Agricultural Sector in Nigeria.

2. REVIEW OF RELATED LITERATURE

Concept of Fiscal Policy

Fiscal policy is a term conventionally associated with the use of taxation and public expenditure to influence the level of economic activities in any given country, developed or developing. The implementation of fiscal policy is essentially routed through the government's budget. The budget is, therefore, more than a plan for administering the government sector. The budget reflects and shapes a country's economic life. In fact, the most important aspect of a public budget is its use as a tool in the management of a nation's economy, designing and implementing fiscal policy, government plans for the budget deficit, budget surplus or balanced budget. The budget deficit is a type of budget plan in which government expenditure outweighs its revenue while the budget surplus is a budget plan where government revenue is proposed to be greater than government expenditure. A balanced budget, however, arises when government expenditure equals government revenue (Omitogun and Ayinla, 2007; Heakel, 2015).

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 (CBN) (2011) defined fiscal policy as the use of government expenditure and revenue collection through tax and amount of government spending to influence the economy. Samuelson and Nordhaus (2002), defined fiscal policy as a government's program with respect to the purchase of goods and services and spending on the transfer of payments, as well as 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 (David, 2005; Mark and Asmaa, 2009; Chirag, 2010). This implies that Fiscal policy refers to the use of the government budget to influence economic activities.

Components of Fiscal Policy in Nigeria

Government Capital Expenditure (GCE)

Government expenditures play key roles in the operation of all economies. It refers to expenses incurred by the government for the maintenance of itself and provision of public goods, services, and works needed to foster or promote economic growth and improve the welfare of people in the society. Government (public) expenditures are generally categorized into expenditures on administration, defense, internal securities, health, education, foreign affairs, etc. and has both capital and recurrent components. 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/improvement of existing fixed assets such as lands, buildings, 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 (Oziengbe, 2013). Aggregate government capital expenditure at current prices will be used. It is expected that the increase in capital expenditure, will increase real sector growth because people's welfare will improve through government provision of social and infrastructural facilities. This will directly reduce unemployment, thus leading to a positive impact on the real sector.

Components of Real Sector

Agricultural Sector Growth

Agriculture is the mainstay of the Nigerian economy, directly contributing 60 percent of the GDP annually in the 1960s. The sector accounts for 70 percent of total Nigerian exports and provides more than 70 percent of informal employment in rural areas. Therefore, the agricultural sector is not only the driver of the Nigerian economy but also the means of livelihood for the majority of Nigerian people (Lawal, 1997). Agricultural sector development suffered total neglect as a result of the oil boom in the 1970s, and this neglect continues to the extent that Nigerian agricultural sector cannot afford to produce what her citizenry will consume not to talk about exporting of the produce. The present-day problem of the Nigerian economy is as a result of total neglect of the agricultural sector and increased dependence on a mono-cultural economy based on oil. The contribution of agriculture to Nigeria's GDP now lies within 5% (Olagbaju and Falola, 1996). In contrast to the economy as a whole, for the full year 2016, real GDP in agriculture grew by 4.11%, and this growth rate was higher than that recorded in 2015 of 3.72%. The contribution of the Agricultural sector as a real sector of the economy to overall GDP in real terms was 25.49% in the quarter under review, higher than its share of 24.18% in the corresponding year (NBS, 2017).

Noko (2017) stated that agriculture is estimated to be the largest contributor to the non-oil foreign exchange. According to him, a strong agricultural sector is essential to economic development both in its own rights and to stimulate and support the growth of industries. Economy growth has gone hand in hand with agricultural progress; stagflation in agriculture is the principal explanation for poor economic performance while rising agricultural activities has been the most concomitant of successful industrialization (Ukeje 1999). The labor-intensive character of the sector reduces its contribution to the GDP; Noko lamented, and still maintained that agricultural exports are a major earner of foreign exchange in Nigeria. Agriculture can be further broken into crop production, livestock, forestry, and fishing.

Empirical Review

There are several studies that have articulated theoretically and empirically on the impact of fiscal policy on real sector growth in the Nigerian economy. Many studies have investigated fiscal policy behavior in developing and developed countries. Results about the effect of fiscal policy on real sector growth differ by country, analytical methods employed and categorization of fiscal policy measures.

Salman and Tahir (2018) examined the impact of real sector shocks on Islamic banking in Pakistan using quarterly data for the period of 2006 to 2016 and applied vector error correction model (VECM). Their result indicates that a shock in large scale manufacturing index has an increasing effect on financing and investments while a shock in the exchange rate has a declining effect. The study also revealed that a shock in large scale manufacturing index has an amplifying effect on non-performing loan, but a shock in the exchange rate does not affect non-performing loan by much.

Monca, Sorin, and Andrei (2018) investigated whether the increase in fiscal pressure leads to a higher level of corruption and whether the results differ from developed to developing countries looking at over 185 countries, during the period 2005–2014. The technique employed was short panel data with five statistical models such as the pooled OLS, pooled FGLS, within the model, between model and random-effects GLS model. They found out that, with high-quality institutions, low fiscal pressure leads to a lower level of corruption, which is in line with expectations.

Victor and Roman (2017) analysed the effects of fiscal policies upon agriculture and industry in Ukraine, with the SVAR model using quarterly data for the 2001–2016 period. The results indicate a positive effect of the government spending on both agricultural production and industrial output, while an increase in the government revenue is of the same expansionary impact for the latter only. Among other results, there was a weak negative short-lived spillover from agriculture to industry, with no causality running on the reverse. As agricultural production in Ukraine is associated with a higher level of government spending in the short run, a direction of causality seems to be just the opposite for industrial output. Both agriculture and industry bring about higher budget revenues in the short run, but for the latter, this effect is lagged and more persistent. Controlling for fiscal policy effects, the nominal (real) exchange rate depreciation seems to be expansionary for industrial output. For agriculture, a nominal exchange rate depreciation is restrictionary in the short run, with an expansionary effect in the long run (however, this result is not supported in specification with the real exchange rate).

Eze (2017) investigated the effect of the interest rate liberalization policy of the government (introduced in 1986 under the structural adjustment programme) on the performance of the industrial sector in Nigeria. Vector error correction model (VECM) were used. The study shows that exchange rate volatility has an insignificant positive impact on industrial output performance. It also shows evidence of the significant positive impact of lending rate and financial depth on industrial output growth. However, evidence from the study shows that inflation has a significant negative effect on the output of the sector. To enhance the performance of the sector in Nigeria, the government should seek to stabilize exchange rate movements through proper diversification of sources of foreign exchange inflow as well as reduce its outflow in order to support her import-dependent industrial sector while simultaneously pursuing the development of an adequate and efficient infrastructure base for the economy.

Harris, Dimitris, Dimitris and Evangelia (2017) used macroeconomic models that omit the shadow economy systematically mis-forecast and mis-measure to study the effect of fiscal –in particular tax– policy on economic activity and tax revenue. It was discovered that the size of fiscal adjustment and the drop in economic activity could have been considerably milder had the informal sector been curtailed (it instead increased by about 50%).

Sandra, Alar, Eduardo, and Giselle (2017) applied a comprehensive tax-benefit incidence analysis to estimate the distributional effects of fiscal policy in Chile in 2013. It was found out that there is an overall positive effect of fiscal interventions on poverty and inequality.

Ivo (2017) examined different arguments for fiscal contraction and fiscal expansion, considering the level of indebtedness of a country and the economic circumstances. It finds that high debt-to-GDP ratios are a burden on

the economy that represents a progressive cost to government deficit, which it captures through introducing the concept of a debt multiplier. It also finds that recessions strongly increase the benefits of fiscal spending, both in the short-run and in the long-run through hysteresis-effects.

Arikpo, Ogar, and Ojong (2017) examined the impact of fiscal policy on the performance of the manufacturing sector in Nigeria. The study was specifically meant to assess the extent to which government revenue and expenditure impact on the manufacturing output in Nigeria. To achieve these objectives, relevant literature was reviewed. An *ex-post facto* research design was adopted for the study. Time-series data were collected from the CBN statistical Bulletin using the desk survey method from 1982 to 2014. The data were analyzed using the ordinary least square multiple regression statistical technique. Result revealed that increases in government revenue reduce manufacturing sector output in Nigeria. Finally, the Government should increase its expenditure on infrastructural development and community services as this will have a multiplier effect on manufacturing activities and enhance economic growth in Nigeria.

Jelilov (2016) examined the impact of interest rate on economic growth in Nigeria from 1990 to 2013. The result found that the interest rate has a slight impact on growth; however, the growth can be improved by lowering the interest rate, which will increase the investment. As a result of the study, it was found out that Nigerian authorities should set interest rate policies that will boost the economic growth. Therefore, the proper measure should be taken in order to have a more rapid economic growth.

Theoretical Framework

Based on the nature of this study, the theoretical framework adopted were Savers-Spenders Theory of Fiscal Policy.

The Savers-Spenders Theory of Fiscal Policy

This theory was propounded by Mankiw (2002) as a result of inconsistency of Barro-Ramsey (1994) theory of infinitely-lived families and Diamond Samuelson (1965) theory of overlapping generation, respectively. Mankiw (2002) theory of savers – spenders has been used by various scholars like Matsen Seveen and Torvik (2008), Eze and Ogiji (2013). The savers-spenders theory of (2002) captures an economy of being made up of two different groups; the savers and spenders respectively where savers are full rational intertemporal maximizers, whereas spenders consume their entire after-tax labour income in every period.

3.0 RESEARCH METHODOLOGY

This study made use of *Ex-post facto* research design. Onwumere (2009) states that *ex-post facto* design is the type of research involving events that have already occurred. The data already exists as no attempt would be made to control or manipulate the relevant independent variable. This study covered the effect of government capital expenditure on agricultural sector growth in Nigeria for the period under review-1980-2017. The reason for this is because; it was a period when there was an increase in government spending with low returns from the agricultural sector in Nigeria. The period has also been considered adequate enough to generate good result from regression analysis which is the method that is relevant in testing the hypotheses formulated for the study. Based on the above, the model for this study were, therefore estimated as follows:

$$AGDP = f(GCE, INFL, EXR, INTR) \dots (1)$$

$$\text{i.e. } AGDP = \beta_0 + \beta_1 GCE + \beta_2 INFL + \beta_3 EXR + \beta_4 INTR + u_t \dots (2)$$

WHERE;

A/GDP = Agriculture Sector Contribution to AGDP/GDP

GOR = Government Capital Expenditure

INFL = Inflation Rate

EXR = Exchange Rate

U = Stochastic error term

4.0 Result and Discussion

Descriptive Test

The descriptive statistics of data series gives information about simple statistics such as mean, median, minimum value, maximum value and the distribution of the sample measured by skewness, kurtosis and the Jarque-Bera statistic and it was used in this study to. The descriptive result is presented in table 1.

Table 1: Descriptive Statistics

Parameters	AGDP	GCE	INFL	INT	EXR
Mean	23.38	36.67	20.09	13.54	82.30
Median	22.88	35.41	12.55	13.25	57.37
Maximum	37.52	63.44	76.76	27.00	35.60
Minimum	14.43	9.41	0.22	6.13	0.55
Std. Dev.	5.07	15.22	18.24	5.19	86.30
Skewness	0.53	0.16	1.64	1.04	1.12
Kurtosis	3.29	2.07	4.72	4.02	4.23
Jarque-Bera	1.93	1.53	21.71	8.49	10.31
Probability	0.38	0.47	0.00	0.01	0.01
Sum	888.43	1393.28	763.32	51.62	31.23
Sum Sq. Dev.	950.14	8571.31	123.52	97.72	27.20
Observations	38	38	38	38	38

Source: Author's Computation 2019

Table 1 above reports the overall mean and standard deviation for all the variables involved in this standard regression analysis. The mean of the dependent variables chosen which is agricultural sector contribution to the growth of Nigerian economy (AGDP) is 23.38 which is not all that very low compared to the mean of other independent variables which are the variables of government oil revenue. With the mean value of GCE standing at 36.67 while those of INF, INTR, and EXR are 20.09, 13.54 and 82.30 respectively, we can conclude that EXR has the highest mean value, followed by AGDP, INFL, then, INTR. The standard deviation of each variable (AGDP, GCE, EXR, INTR, and INFL) with 5.07, 8.95, 18.24, 5.19 and 86.30 respectively appears to follow the same hierarchical trend as those of the mean values.

The above result indicates that all the variables displayed a high level of consistency as their mean and median values are perpetually within the maximum and minimum values of these series. Besides, the standard deviation revealed that actual data in the series are not really different from the mean value. The skewness and kurtosis statistics provide useful information about the symmetry of the probability distribution of various data series as well as the thickness of the tails of these distributions respectively. These two statistics are particularly of great importance since they are of use in the computation of Jarque-Bera statistic, which is used in testing for the normality or asymptotic property of a particular series.

4.2 Graphical Trend

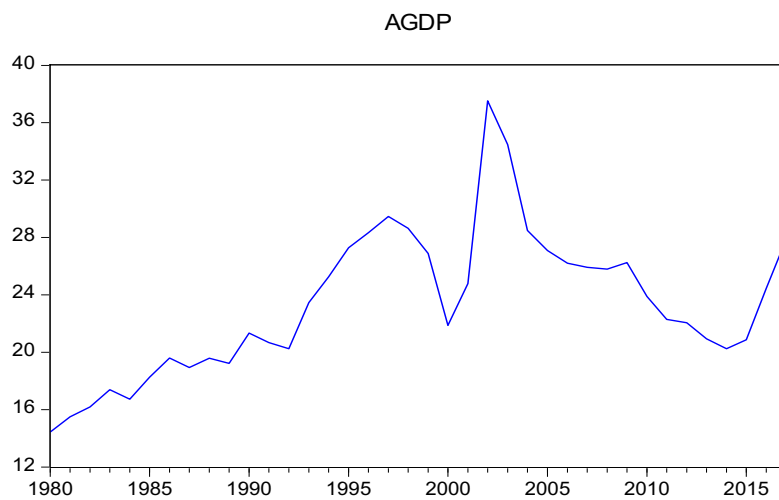


Figure 1. Trend analysis of AGDP (1980-2017).

Source: Author's computation 2019.

Figure 1 shows the graphical trend of agricultural sector contribution to Gross Domestic Product (AGDP) in Nigeria for the period 1980-2017. From 1980 to 1983 there was a steady increase, but in 1984, there was a slight decrease. From 1985, it picked with 18.26% and continued with minimal fluctuation increase until 2002 where reached the highest peak of 37.52%. The graphical analysis shows that agricultural sector contribution to Gross Domestic Product (AGDP) in Nigeria had the highest contribution of 37.52% in 2002 followed by 34.48% in 2003, and the lowest in 1980 with 14.43 followed by 1981 with 15.5%. From 2008 to 2017, it recorded an increase with minimal fluctuation. Since agricultural sector contribution to Gross Domestic Product (AGDP) in Nigeria has a greater effect on the economy and indicate the level of real sector contribution on economic growth, we can say that agricultural sector contribution to gross domestic product (AGDP) in Nigeria will over the years under study have minimal fluctuation.

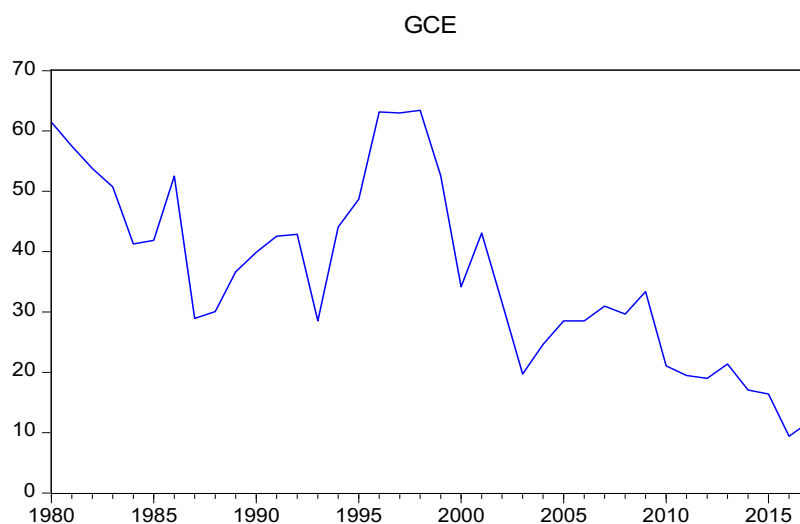


Figure 2. Trend analysis of GCE (1980-2017).

Source: Author's computation 2019.

From Figure 2, the trend of government capital expenditure (GCE) is clearly shown. From the year 1980 up till 1984, the level of government capital expenditure implementation has been on decrease from 61.45% to 41.28% in 1984. From 1985, it started ascending with 41.87% to 52.53% in 1986. It dropped again to 28.93% in 1987, but in 1988, it increased again to 30.5%. This increase continued till 1991 with 42.59%. By 1993, it decreased to 28.50% and ascension to 1996 with 63.14%. From 1997 to 2017, there has a downward inconsistency trend on the

level of government capital expenditure implementation. This may be attributed to the fact that those periods of inconsistency were marked by various unstable macroeconomic policies and political instabilities which discouraged the inflow of foreign direct investments in Nigeria because of lack of proper government capital expenditure implementation. This is a situation which could be explained from that the level of government capital expenditure implementation was not enough for the growth of the Nigerian real sector during the period.

4.4 Akaike Information Criteria Test

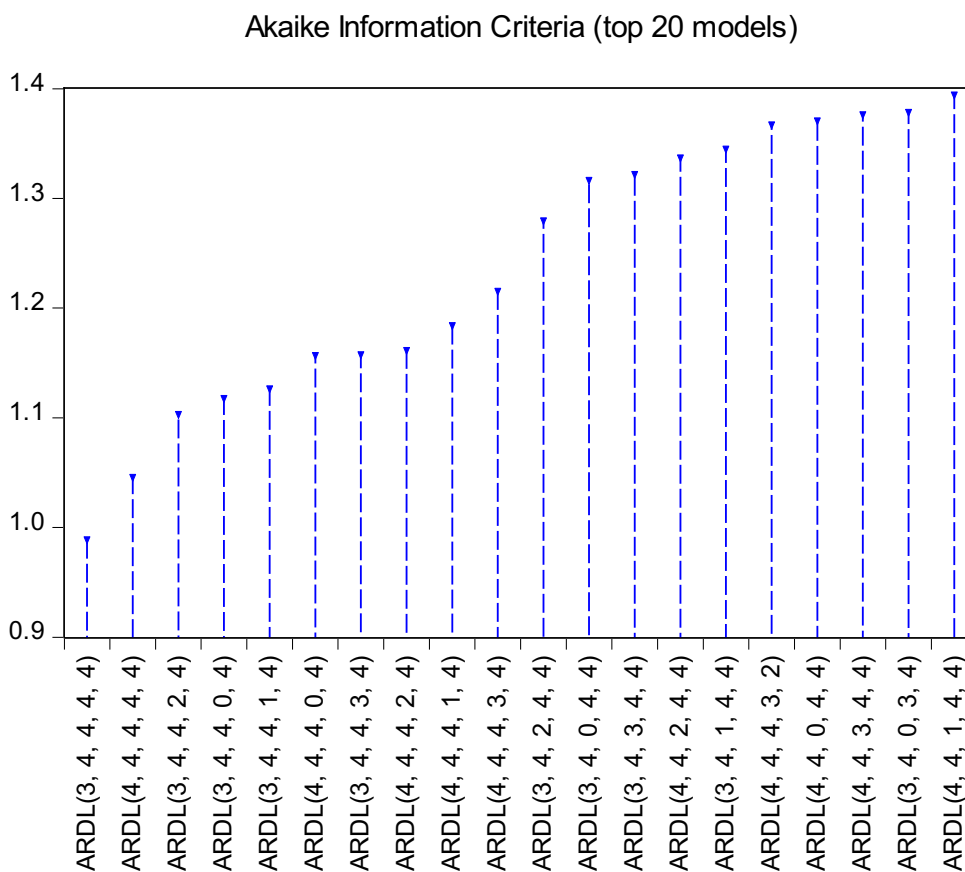


Figure 3: Akaike Information Criterion (AIC)

The Akaike Information Criterion (AIC) graph above shows the model selection value for the twenty best-estimated models with the lowest criterion value. To achieve parsimony, the model with the least AIC, that is ARDL (3, 4, 4, 4, 4) is selected to determine the error correction and long-run models.

To verify whether the residuals from the model are serially uncorrelated, in the estimation view, we proceed to Residual Diagnostics/Serial Correlation LM Test and select the number of lags. In our case, we chose 4. Here's the output

4.6 Error Correction Mechanism

The table 2 below shows the ARDL co integration test results for $AGDP_t = \beta_0 + \beta_1 GCE_t + \beta_2 EXR_t + \beta_3 INT_t + \beta_4 INFL_t + \mu_t$

Table 2: ARDL Co-integration Test for First Model (AGDP)

Dependent Variable: AGDP

Method: ARDL

Dynamic regressors (4 lags, automatic): GOR GRE GCE GBD

Fixed regressors: INFL INT EXR

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
AGDP(-1)	0.320060	0.378047	0.846615	0.4218
AGDP(-2)	0.007651	0.402734	0.018997	0.9853
AGDP(-3)	-0.148632	0.337680	-0.440156	0.6715
AGDP(-4)	0.536512	0.251097	2.136672	0.0651
GCE	0.120569	0.193906	2.621795	0.0014
GCE(-1)	0.349069	0.226972	1.537935	0.1626
GCE(-2)	-0.477490	0.253855	-1.880958	0.0968
GCE(-3)	-0.226122	0.297481	-0.760124	0.4690
INFL	0.014195	0.055190	0.257200	0.8035
INT	0.434367	0.169070	2.569148	0.0332
EXR	8.50E-05	0.015560	0.005463	0.9958
R-squared	0.969790	Mean dependent var		24.26235
Adjusted R-squared	0.875384	S.D. dependent var		4.585526
S.E. of regression	1.618733	Akaike info criterion		3.883658
Sum squared resid	20.96238	Schwarz criterion		5.050875
Log-likelihood	-40.02218	Hannan-Quinn criter.		4.281712
Durbin-Watson stat	2.506320			

Source: Author's Computation 2019.

Table 2 shows the result of ARDL co-integration test which tests the long run equilibrium relationship between the variables in the model. From table 2, we observe the presence of a long-run relationship between the variables using lag 4. The result above shows that there are significant effects of the lags of some of the fiscal policy variables on agricultural sector contribution to GDP (AGDP). We have a significant effect of the fourth lag of AGDP, and the third lag of Government Capital Expenditure has a significant effect on Agricultural Sector Contribution to GDP at 10%, implying that the current Government Capital Expenditure would affect Agricultural Sector Contribution to GDP in the next 3 years.

The table above indicates the long-run equilibrium and short-run dynamics of government capital expenditure on agricultural sector contribution to GDP (AGDP). The Long and short-run coefficients show that the coefficient of government capital expenditure (GCE) lag one has a significant effect on agricultural sector contribution to GDP (AGDP) [sig. = 0.0014], and a one percentage increase in government capital expenditure leads to a 96.97% increase in agricultural sector contribution to GDP. The short-run dynamics of government capital expenditure on agricultural sector contribution to GDP showed that government capital expenditure has a significant and positive effect on agricultural sector contribution to GDP (AGDP) [sig. = 0.0014] and a one percentage increase in government capital expenditure leads to 96.97% decreases in agricultural sector contribution to GDP. This may be as a result that any change in the course of any year as regard to government capital expenditure will only start having an influence on agricultural sector contribution to GDP after the year that the change is made.

5.0 Conclusion and Recommendations

5.1 Conclusion

Based on the findings of this study, we conclude: that there is a significant effect of government capital expenditure on the growth of the agricultural sector in Nigeria. The implication of the study is that fiscal policy through government capital expenditure will increase the agricultural sector growth and thereby increases its contributions

to the growth of the economy. This means that when there is enough revenue, the government only spends more money on infrastructural development that can help the agriculture sectors to grow by having access to good road and electricity. The result is an indication that government capital spending in Nigeria has been able to spur the economic growth of Nigeria through agricultural sector output.

5.2 Recommendations

Based on the findings, the study makes the following recommendations;

1. Government of Nigeria should adhere strictly to the implementation of government spending so as to increase the level of real sector development in Nigeria which will have the capacity to stimulate economic growth and create employment.
2. Government of Nigeria should formulate appropriate policy mix that would motivate the firm in the oil sector to enhance improved performance and contribution of the sector.

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