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Analyzing the Impact of Public Expenditure on Economic Development: Evidence from Nigeria

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Abstract

This study thoroughly investigates the intricate relationship between public expenditure and economic development in Nigeria by employing advanced econometric techniques such as cointegration and causality analysis. Economic development, a multifaceted concept, is measured using the gross domestic product per capita, while public expenditure is delineated based on sectoral allocations provided by the Central Bank of Nigeria spanning the period from 1981 to 2015. Through a rigorous analytical framework comprising tests for stationarity, Ordinary Least Squares estimation, and exploration of cointegration and causality, the study convincingly rejects the null hypothesis positing an insignificant association between public expenditure and economic development in Nigeria. Notably, expenditures allocated to the Administration and Transfers sectors emerge as statistically significant at the 1% level, indicating their substantial impact on Nigeria's economic progress. Conversely, expenditure directed towards economic services demonstrates a weaker influence on economic development, falling short of anticipated expectations. This discrepancy underscores the complexity of public expenditure dynamics and highlights the need for targeted interventions to optimize resource allocation and enhance efficacy. The study sheds light on the underperformance of public expenditure, particularly within the economic and social/community services sectors. This underperformance is attributed, in part, to discrepancies between budgeted and actual expenditures, as well as deficiencies in implementation. Moreover, the study underscores the inadequate attention afforded to sectors directly impacting citizens' welfare, such as economic and social/community services, further exacerbating the observed suboptimal outcomes. The findings of this study underscore the importance of strategic resource allocation and effective implementation in maximizing the impact of public expenditure on economic development in Nigeria. Addressing the identified shortcomings and recalibrating expenditure priorities towards sectors with the greatest potential for socioeconomic impact are imperative steps towards fostering sustainable and inclusive growth.

Keywords: Public Expenditure, Economic Development, Nigeria

JEL Codes: H50, O11, O55

1. INTRODUCTION

Undoubtedly, poverty reduction remains a paramount concern driving policy agendas across the globe, including Nigeria. This imperative is not confined solely to developing economies; even developed nations are actively pursuing strategies to eradicate poverty while fostering sustained economic growth. Governments worldwide are tasked with the responsibility of ensuring access to quality education, healthcare services, electricity, and other critical infrastructure to enhance the welfare of their populations. Prior to 2015, the international community rallied around the Millennium Development Goals (MDGs), placing poverty alleviation at the forefront of global initiatives. This momentum has since evolved into a broader commitment to sustainable development, catalyzing the introduction of programs like Nigeria's National Economic Empowerment and Development Strategy (NEEDS). These initiatives underscore the collective determination to elevate the standard of living for all citizens and foster inclusive growth. The imperative for an improved quality of life has heightened public expectations regarding the efficiency and transparency of public expenditure. There exists a pressing demand for accountable governance and judicious allocation of resources to ensure that public spending yields tangible results in alleviating poverty and fostering sustainable development.

A growing consensus among scholars and academics underscores the pivotal role of public expenditure in addressing poverty and enhancing the economic welfare of citizens. It is widely acknowledged that any genuine economic development endeavor must prioritize sustainable improvements in living standards, including heightened per capita income, enhanced access to education and healthcare, and environmental preservation. Sabatini (2006) aptly recognized the significance of the interplay between societal organization and economic performance, highlighting it as a fundamental inquiry in political economy. This observation remains pertinent in contemporary economic discourse, emphasizing the enduring relevance of understanding the intricate dynamics between governance structures and economic outcomes. In essence, the enduring relevance of public expenditure in fostering poverty reduction and economic advancement underscores its critical role in

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shaping societal well-being. As such, the imperative to optimize the allocation and utilization of public resources remains central to fostering sustainable development and achieving broader societal objectives.

According to insights from Asiedu (2005), the United Nations and the World Bank have unequivocally identified poverty reduction as the pivotal Millennium Development Goal (MDG) to be achieved by the target year of 2015. In consonance with these global aspirations, the New Partnership for Africa's Development (NEPAD) asserts a more resolute stance, contending that to truly fulfill the MDGs, Africa must confront an annual resource gap amounting to a staggering US\$64 billion. This substantial sum represents approximately 12 percent of the region's GDP, underscoring the magnitude of the challenge faced in translating development aspirations into tangible progress. It becomes evident that bridging this formidable resource gap necessitates a multifaceted approach encompassing innovative financing mechanisms, enhanced international cooperation, and domestic policy reforms. Furthermore, it underscores the imperative for African nations to prioritize mobilizing resources effectively, fostering a conducive environment for private sector investment, and promoting inclusive growth strategies that prioritize marginalized communities. Moreover, the realization of the MDGs goes beyond mere financial commitments; it demands a holistic approach that addresses structural barriers, fosters institutional capacity-building, and promotes sustainable development practices. Harnessing the potential of Africa's youthful population, promoting technological innovation, and fostering partnerships for knowledge transfer are essential components of this comprehensive agenda. In essence, the challenge posed by the resource gap outlined by NEPAD underscores the urgency for concerted action and unwavering commitment from both African governments and the international community. Only through collective efforts and innovative strategies can Africa surmount the obstacles to poverty reduction and achieve meaningful progress towards sustainable development and inclusive prosperity.

2. LITERATURE REVIEW

Economic research often yields diverse findings, yet there exists a remarkable consensus among socio-economic analysts regarding the relationship between public expenditure and Economic Development, as noted by Obiyo (2004). In developed nations, public expenditure serves to stabilize and stimulate investment activity, thereby fostering a smooth growth trajectory. Conversely, in underdeveloped economies, the pattern of public expenditure tends to be less uniform, often disrupted by fluctuations in the economic landscape. The significance of public expenditure transcends mere fiscal allocations; it plays an instrumental role in addressing regional disparities, bolstering social infrastructure, and laying the foundation for sustainable economic growth. This multifaceted role encompasses the development of critical infrastructure such as transportation and communication networks, investment in education and training, promotion of capital goods industries, and support for research and development initiatives, among others, as highlighted by Bhatia (2002). It becomes evident that strategic public expenditure is indispensable for promoting inclusive growth, fostering innovation, and enhancing the productive capacity of nations. Moreover, targeted investments in key sectors can catalyze transformative change, unlocking new opportunities for economic advancement and social progress. However, it is crucial to acknowledge that the effectiveness of public expenditure hinges on prudent fiscal management, transparent governance practices, and strategic policy interventions. Moreover, ensuring the equitable distribution of public resources and addressing structural constraints are imperative for harnessing the full potential of public expenditure in driving sustainable development.

Enhancing public expenditure across various social and economic infrastructures emerges as a cornerstone in driving the economy towards sustainable growth and societal well-being. Through strategic investments in critical sectors like education, healthcare, transportation, communication, waste management, electricity, water supply, sanitation, and other essential services, governments pave the path for multifaceted benefits. These allocations not only nurture burgeoning industries but also act as a potent tool in combating unemployment, stabilizing market prices, eradicating poverty, and uplifting the overall standard of living for citizens. Furthermore, robust public spending serves as a catalyst for economic expansion by bolstering confidence among investors, both domestic and international, thereby stimulating higher levels of productivity and innovation across various sectors (Karras, 2007).

The prevailing consensus suggests that public expenditure, particularly on physical infrastructure or human capital, holds the potential to enhance economic growth. However, the financing of such expenditures can paradoxically impede growth due to the disincentive effects of taxation. This perspective finds support in the work of Kweka and Morrissey (2000), who emphasized that public expenditure can directly or indirectly influence economic growth through government activities that augment total output in collaboration with the private sector. Echoing this sentiment, Lin (1994) succinctly stated that the positive impact of public expenditure becomes tangible when governments allocate funds towards providing public goods, infrastructure, social services, and targeted interventions such as export subsidies.

According to Barro (1990), government spending on investment and productive endeavors is expected to have a positive impact on economic growth, while government consumption spending may hinder growth. However, a significant challenge arises from the empirical difficulty in discerning which expenditures should be classified as investment and which as consumption (Muritala and Taiwo, 2011). This distinction poses complexities in accurately assessing the economic effects of different types of government spending.

Despite numerous studies conducted in this field, consensus remains elusive, and consistent evidence supporting this perspective is lacking (Oyinlola, 1995; Kweka and Morrissey, 2000; Mitchell, 2005; Akpan, 2005; Adewara and Oloni, 2012). In fact, the findings have been varied, with evidence differing across countries or regions, analytical methodologies

employed, and categorization of public expenditures. The diversity of results underscores the complexity of the relationship between government spending and economic growth, highlighting the need for further research and nuanced analysis. The relationship between government spending and economic growth holds particular significance for developing countries. These nations often exhibit high levels of public expenditure over time, which are frequently accompanied by escalating fiscal deficits. This implies a challenge in generating sufficient revenue to sustain elevated expenditure levels (Lindauer and Valenchik, 1992; Adesoye et al., 2010).

In traditional Keynesian macroeconomics, various types of public expenditures, even if recurrent, can contribute positively to economic growth by triggering multiplier effects on aggregate demand. However, government consumption may crowd out private investment, thereby dampening short-term economic stimulus and reducing long-term capital accumulation. The phenomenon of crowding out primarily arises from fiscal deficits and their impact on interest rates (Diamond, 1989).

Research employing endogenous growth models delineates between two distinct categories of taxation and expenditure: distortionary and non-distortionary, as well as productive and unproductive expenditures. Distortionary taxation introduces inefficiencies into the market by altering relative prices and distorting resource allocation, while non-distortionary taxation imposes a minimal impact on market behavior. Furthermore, expenditures are classified as productive if they are seamlessly integrated into private production functions, directly contributing to economic output and growth. Conversely, unproductive expenditures are those that lack a direct linkage to productive activities and fail to stimulate economic expansion. Baro and Sala-I-Martin (1992) contend that this classification underscores the differential impact of expenditures on economic growth. Productive expenditures exert a direct influence on the growth rate by enhancing the productive capacity of the economy and fostering innovation, thereby fueling sustainable economic expansion. In contrast, unproductive expenditures may have either an indirect effect on growth or no impact at all, as they do not contribute directly to the enhancement of productive capacity or efficiency within the economy. The distinction between productive and unproductive expenditures underscores the importance of prioritizing investments that yield tangible returns in terms of economic growth and development. By directing resources towards productive activities that enhance the economy's productive capacity and efficiency, policymakers can foster sustained and inclusive economic growth, laying the foundation for long-term prosperity and well-being.

3. THE MODEL

The dataset utilized in this study draws from the functional classification provided by the Central Bank of Nigeria Statistical Bulletin (2015). Within this dataset, various sources of public expenditure were examined in relation to the actual per capita gross domestic product (GDPpc) figures for the corresponding period. To gauge the overall significance of the independent variables collectively (i.e., model significance), the F-ratio test was employed. This statistical test assesses whether the entire set of independent variables together significantly explains the variation in the dependent variable, which in this case is the per capita GDP. Furthermore, to ascertain the significance of each individual explanatory variable or component of public expenditure on economic development in Nigeria, the student t-ratio test was utilized. This test allows for the examination of the statistical significance of each independent variable, indicating whether they exert a significant impact on the dependent variable when considered individually. By employing both the F-ratio and student t-ratio tests, this study endeavors to conduct a comprehensive analysis of the relationship between public expenditure and economic development in Nigeria. Through this approach, the collective and individual contributions of different expenditure components to the observed variations in per capita GDP over the specified time period can be elucidated, providing valuable insights into the dynamics of public expenditure and its implications for economic growth and development.

The functional form of the relationship is given as;

$$GDPC_t = f(TOTADMIN_t, TOTECO_t, TOTRAF_t, TOTSOC_t, \mu_t)$$

Where;

$GDPC_t$ = Per Capita Gross Domestic Product

$TOTADMIN_t$ = Total Expenditure on Administration

$TOTECO_t$ = Total Expenditure on Economic Services

$TOTRAF_t$ = Total Expenditure on Transfers

$TOTSOC_t$ = Total Expenditure on Social and Community Services

μ = Stochastic Term

4. RESULTS AND DISCUSSION

The table presents the outcomes of unit root tests for a set of variables, employing both the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests. These tests are foundational in identifying whether a time series is stationary or has a unit root, indicating non-stationarity. In the realm of time series analysis, ensuring data stationarity is crucial as it means the statistical properties of the series—like mean and variance—remain constant over time, a prerequisite for many forecasting models. For each variable examined—TOTADMIN, TOTECO, TOTSOC, and TOTRAF—the table delineates T-statistics and corresponding critical values for both tests, alongside the order of integration. The order of integration is a critical piece of information, indicating the number of differences required to make a series stationary. Specifically, a designation of I(1) suggests that first differencing the series yields stationarity, while I(2) implies that two levels of differencing are needed.

The results for TOTADMIN show that both the ADF and PP tests converge on the series achieving stationarity after first differencing, as indicated by their respective T-statistics being more negative than the critical values. This consistency across both tests strengthens the confidence in the finding that TOTADMIN is I(1). However, TOTECO presents a notable discrepancy between the two tests. The ADF test suggests that TOTECO becomes stationary only after second differencing (I(2)), a contrast to the PP test's indication of stationarity after the first differencing (I(1)). This divergence suggests that further analysis might be necessary for TOTECO to conclusively determine its order of integration, as differing levels of differencing can significantly impact the subsequent analysis and modeling of the series. For TOTSOC and TOTRAF, the findings are consistent across both testing methodologies, with both series becoming stationary after the first differencing (I(1)). This alignment between the ADF and PP tests provides a clear directive for analysts on how to preprocess these series for time series modeling. In short, the unit root tests suggest that with the exception of TOTECO, which presents a discrepancy between the ADF and PP tests regarding its order of integration, all variables tested require first differencing to achieve stationarity. This indication is pivotal for subsequent time series analysis, as it dictates the preprocessing steps needed to render the data suitable for models that assume stationarity. The case of TOTECO, however, underscores the importance of employing multiple tests to ascertain the stationarity of a series, especially when initial tests yield conflicting results.

Table 1: Unit Root Test for the Variables Employed

Variable	T-statistic.	ADF Unit Root Test			PP Unit Root Test		
		Critical Value	Order of Integration	T-Statistic.	Critical Value	Order of Integration	
TOTADMIN	-5.434017	-3.711457	1(1)	-6.038813	-4.284580	1(1)	
TOTECO	-12.08003	-3.679322	1(2)	-8.123169	-4.284580	1(1)	
TOTSOC	-5.040008	-3.661661	1(1)	-5.650904	-4.284580	1(1)	
TOTRAF	-3.710784	-3.661661	1(1)	-5.095330	-4.284580	1(1)	

Table 2 presents the outcomes of a regression analysis with GDPC (Gross Domestic Product per capita) as the dependent variable. Each row represents a different independent variable, along with its coefficient, standard error, t-statistic, and probability value. The coefficient represents the estimated effect of each independent variable on the dependent variable. For instance, the coefficient for TOTADMIN is 0.925713, suggesting that a one-unit increase in TOTADMIN is associated with an increase of approximately 0.93 units in GDPC, holding other variables constant. The standard error indicates the variability or uncertainty in the estimated coefficient. The t-statistic measures the significance of each independent variable's coefficient. A higher absolute value of the t-statistic suggests a more significant relationship between the independent variable and the dependent variable. The probability value (Prob.) associated with each t-statistic indicates the probability of observing the t-statistic if the null hypothesis (that the coefficient is zero) is true. Smaller probability values suggest more significant relationships. Additionally, the table provides summary statistics for the regression model. R-squared (0.982405) indicates the proportion of the variance in the dependent variable (GDPC) explained by the independent variables. In this case, approximately 98.24% of the variance in GDPC is explained by the independent variables. Adjusted R-squared (0.979891) adjusts the R-squared value for the number of predictors in the model. S.E. of regression (88.41998) represents the standard error of the regression, indicating the average deviation of the observed values from the predicted values. F-statistic (390.8386) tests the overall significance of the regression model. A smaller probability value associated with the F-statistic suggests that at least one independent variable in the model has a non-zero coefficient. Durbin-Watson statistic (1.287910) tests for autocorrelation in the residuals. A value around 2 suggests no significant autocorrelation. Prob(F-statistic) (0.000000) is the probability associated with the F-statistic. A small value suggests that the regression model is significant overall. In summary, the regression analysis indicates that TOTADMIN and TOTRAF have significant positive relationships with GDPC, while TOTECO does not appear to be statistically significant. TOTSOC also does not show a statistically significant relationship with GDPC. The high R-squared value suggests that the model explains a substantial portion of the variability in GDPC.

The model estimated in this study demonstrates a significant relationship between public expenditure and per capita gross domestic product (GDP) in Nigeria, with statistical significance observed even at the 1% level. Notably, public expenditure on administration and transfers emerged as statistically significant variables, exhibiting the expected positive relationship with per capita GDP. However, public expenditure on social and community services, while demonstrating the correct sign, did not exert a statistically significant impact on per capita GDP. Similarly, public expenditure on economic services, despite displaying a negative coefficient, failed to attain statistical significance. The overall model, boasting an impressive R-squared value of 98.2%, indicates that the explanatory variables collectively explain approximately 98% of the total variations in per capita GDP. This suggests that the model effectively captures the relationship between public expenditure and economic development in Nigeria, leaving only a minimal portion of approximately 2% to chance occurrences. In summary, the findings of this model underscore the importance of prudent allocation and effective utilization of public

expenditure in driving economic growth and development in Nigeria. While certain expenditure categories demonstrate significant positive effects, others may require further scrutiny and refinement to enhance their impact on per capita GDP.

Table 2: Regression Outcomes

Variable	Dependent Variable: GDPC		t-Statistic	Prob.
	Coefficient	Std. Error		
C	924.0564	20.32221	45.47026	0.0000
TOTADMIN	0.925713	0.210836	4.390684	0.0001
TOTECO	-0.373679	0.205878	-1.815050	0.0802
TOTRAF	0.672023	0.164900	4.075345	0.0003
TOTSOC	0.112305	0.251329	0.446842	0.6584
R-squared	0.982405	Mean dependent var		1398.760
Adjusted R-squared	0.979891	S.D. dependent var		623.5322
S.E. of regression	88.41998	Akaike info criterion		11.94080
Sum squared resid	218906.6	Schwarz criterion		12.16754
Log likelihood	-192.0232	Hannan-Quinn criter.		12.01709
F-statistic	390.8386	Durbin-Watson stat		1.287910
Prob(F-statistic)	0.000000			

5. CONCLUSIONS

There is an urgent imperative for robust oversight and guidance of government authorities responsible for public expenditure. Effective monitoring mechanisms are essential to mitigate the risk of funds misappropriation, thereby safeguarding against potential setbacks to economic growth and development. As evidenced by the findings of this study, instances where government spending fails to catalyze economic progress and instead hampers development signify a concerning trend that warrants immediate attention and remedial action. In light of these challenges, it is imperative for agencies such as the Economic and Financial Crimes Commission (EFCC) to redouble their efforts in combatting corrupt practices within government institutions. Heightened vigilance and proactive measures are necessary to curb the pervasive culture of corruption that threatens to undermine the integrity of public expenditure and erode public trust in governance. The study advocates for swift and decisive prosecution of offenders as a critical deterrent against future misconduct. By holding accountable those who engage in fraudulent activities, authorities can send a clear message that malfeasance will not be tolerated and that there are tangible consequences for violating the public trust. In conclusion, it is imperative that concerted efforts be made to enhance transparency, accountability, and integrity in the management of public funds. These efforts are essential for fostering sustainable economic growth and development. Only through vigilant oversight, effective enforcement of anti-corruption measures, and stringent punitive actions can governments ensure that public expenditure fulfills its intended purpose of advancing the welfare and prosperity of the populace. By promoting transparency, governments can build trust and confidence among citizens, investors, and international partners. This, in turn, can attract investment, stimulate economic activity, and spur innovation, all of which are crucial for sustained economic growth. Additionally, accountability mechanisms ensure that public funds are used efficiently and effectively, minimizing waste and mismanagement. This not only maximizes the impact of public spending but also fosters a conducive environment for private sector investment and entrepreneurship. Furthermore, maintaining integrity in the management of public funds is paramount for upholding the rule of law and preserving the credibility of government institutions. By combating corruption and unethical practices, governments can safeguard public resources and ensure that they are directed towards priority areas such as infrastructure development, healthcare, education, and social welfare programs. In essence, the promotion of transparency, accountability, and integrity in public financial management is not only a moral imperative but also a strategic imperative for achieving sustainable economic development and improving the quality of life for all citizens. Governments must therefore prioritize these principles and take decisive action to root out corruption, strengthen governance structures, and build robust institutions that serve the best interests of society as a whole.

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