Africa's Capital Market Development:

ISSUES IN CORPORATE GOVERNANCE AND ECONOMIC GROWTH

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Ndubisi I. Nwokoma
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CHAPTER - 11

INVESTIGATING THE NEXUS OF MACROECONOMIC POLICY AND ITS OUTCOME IN NIGERIA: PUBLIC SPENDING VERSUS CITIZEN'S WELFARE

Isaac Chii Nwaogwugwu and Gbenga A. Odeyemi

ABSTRACT

The fundamental essence of governance is to cause an improvement on the welfare level of the citizenry. Hence, concerns on how much resource the government of a nation spends in achieving this objective may be reflected in terms of how 'much financial resources these government activities leave in the hand of the citizenry'. These financial resources in the hands of the citizenry to a great extent determine their welfare especially with respect to consumption of private goods. This study therefore, aims at investigating the relationship between macroeconomic policy of the government of Nigeria (as reflected in public expenditure per capita and the outcome of such policy initiatives (as reflected in national income per capita. This also reflects welfare of the citizenry). Annual data over the period 1980 to 2012 were used used for the computation. The result of Johansen cointegration revealed that there is a long run relationship among the stationary (1ˢᵗ difference) variables which existed. Further, a unidirectional causality was observed, that is, from national income per capita to Government expenditure growth per capita. Thus, Wagner's law is supported by the data, in the short run. The results are also suggestive of the fact that per capita government spending is predicated on the welfare level of the citizenry and not the other way round.

Keyword: Cointegration, National Income, Welfare, Causality, Public Expenditure.

INTRODUCTION

Concerns around how much resource the government of a nation spends in achieving its proposed aims and objectives, the level to which the objective is achieved alongside the cost and benefit of such achievement in regard to the social wellbeing

of the citizenry of the nation involved cannot be overemphasised. If the government has spent so much in running the state, then how much do the citizenry (firms and household) have access to in running their own homes and businesses? The government remains the highest spender and greatest redistributor of wealth, [Gillespie (1965), Dodge (1975). Ruggles and O'Higgins (1981), Gemmell (1985), Van't Eind *et al.,* (1986), Piggott and Whalley (1987), Menchik (1991), Evandrou *et al.,* (1993), Sefton (2002)]. This view is supportive of the contemporary theory of Public Finance which emphasises government functions with respect to Allocation of resources, stabilisation of macroeconomic variables and income redistribution. See Mugrave and Musgrave (1973). An answer to this kind of question will make us understand how monies run in the society and what policy to adapt or integrate to make the economy run more smoothly while impacting the life of individuals that make up the citizenry.

This paper seeks to investigate whether "monies available to the citizenry (firms and household) are offshoots of government expenditure or vice versa?" A testable thesis in the present study is whether public expenditure leads to the welfare of the people especially in terms of the income available to them. The money available to them gives them the liberty to appropriately define and enjoy welfare especially for concerns that are not necessarily pure "public good" Barnard (2009), or national income triggers an expansion of government expenditure in Nigeria. A study of the relationship between Government expenditure and national income is worthwhile and has received increased attention from researchers both in public finance literature and in the literature dealing with macroeconomic modelling. The public sector absorbs a relatively large share of country's economic resources. The development process itself leads to a variety of economic activity which, in turn, leads to further growth in the economy. The contribution of exports (export led growth) (Khalafalla and Webb, 2001) as well as the role of banking (Tang, 2000; and Tang and Idris, 2001) cannot be excluded in the development of Nigerian economy.

Considering the classical approach, Wagner's hypothesis (Wagner, 1890) views public expenditure as an endogenous factor or as an outcome of growth in national income. As per capita income increases, the share of public expenditure is expected to rise in order to meet the increased protective, administrative and educational functions of the state. Wagner's law perceived that public expenditure played no role in economic growth, and did not qualify as development finance and therefore, may not as such cause an increase in the welfare of the citizenry. Hence, it cannot be relied upon as a policy instrument (Ansari *et al.,* 1997). The rationale behind Wagner's law (Bird, 1971) is that firstly, industrialisation gives rise to an increased scale of government activities, which arise from the administrative and protective

functions of the state; secondly, is to ensure the proper operation of market forces, and finally is the provision of social and cultural goods. Wagner's law is often considered as a long run relationship, which is expected to apply to countries during their early stages of growth and development (Ansari, 1993).

Contrary to Wagner's view, Keynesian hypothesis (Keynes, 1936) stressed that public expenditure is seen as an exogenous factor that can be used as a policy variable, and which can impact upon growth and development in the short run. This is related to the sources of public spending and its impact on economic activities.

The remaining part of this paper is thus arranged; Section 2 reviews existing literatures on the subject while section 3 shows the methodology employed. Section 4 deals with the empirical results obtained, analyses and its interpretation. Section 5 is devoted to conclusion and and policy recommendation.

LITERATURE REVIEW
A number of existing studies empirically examined the validity of Wagner's and Keynesian thesis in developed or developing countries. Most of these studies have given greater attention to long term relationships (cointegration) and causality between Government expenditure and national output in aggregate. Some empirical findings indicate negative relationship while others show positive relationship between government expenditure and economic growth.

Adopting a Granger causality approach, Conte and Darrat (1988), investigated the causal dimension between public sector growth and real economic growth rates for the OECD countries. Special emphasis was put on the feedback effects from economic growth to government growth that resulted from macroeconomic policy. On the basis of the yielding evidence, government growth has had mixed effects on economic growth rates. For the bulk of the OECD economies however, no discernable impact of government growth on the rate of real economic growth was perceived.

In the case of government involvement as regards implementing price ceiling and control, Glewwe and Van der Gaag (1990), Van de Walle (1998) empirically confirmed that citizens are quite sensitive to pricing and that price regulation greatly influence the value of their real income and consequently the level of welfare they are disposed to especially in Cameroun where their study was carried out.

Barro (1991) in a cross section study of 98 countries for a period spanning from 1960 to 1985, using average annual growth rates in real per capita GDP and the ratio of

real government consumption to real GDP concluded that the relation between economic growth and government consumption is negative and significant. Additional evidence suggested that growth rates were positively related to measures of political stability and inversely related to a proxy for market distortions.

Chen *et al.,* (1994) found that government expenditure in education significantly increased the level of welfare among Malaysian citizens over the period their study queried. They found that government carefully targeted certain ethnics in order to improve their welfare level. Successfully through targeted spending greatly enhanced welfare of her citizenry.

In another study by Ravallion *et al.,* (1995) they developed a methodology to examine the impact of government safety net on vulnerable households in Hungary between 1987 and 1989. They found out that the creation of such safety nets surely prevented vulnerable people from falling into poverty and on the other hand, enabled households to step out of poverty thus confirming the effect of government expenditure and welfare of the people.

There is a need to bear government borrowings in mind especially as it affects welfare in developing countries. Nelson and Singh (1994) found that fiscal deficits of less developing countries (LDCs) have generally increased over the past two decades; there is little or no conclusive evidence that such deficits retarded GDP growth rate. They concluded that fiscal deficits associated with public infrastructure improvements or with the promotion of private investment most likely will enhance economic growth and hence, welfare of the people.

Jong-Wha (1995) produced further evidence on the relationship between government consumption and economic growth. More specifically, by using an endogenous growth model of an open economy, it was found that government consumption of economic output was associated with slower growth. In addition, the composition of investment and the volume of total capital accumulation were also thought to significantly condition economic growth.

Knoop (1999) using time series data from 1970 to 1995 found that a reduction in the size of the government would have an adverse impact on economic growth and welfare. Estimates obtained by Fölster and Henrekson (1999, 2001) when conducting a panel study on a sample of rich countries over the period 1970-1995 lent support to the notion that large public expenditures affect growth negatively. In another empirical study, Ghura (1995), using pooled time-series and cross-section data for 33 countries in Sub-Saharan Africa for the period 1970-1990 produced evidence that

points towards the existence of a negative relationship between government consumption and economic growth. In that study the sample countries were classified into four groups: high-growth countries with growth rates above 2.0%; medium-to-low-growth countries, with growth between 0% and 1.9%; weak-growth countries, with growth between -1.0% and -0.01%; and very-weak-growth countries, with growth below -0.9%. During his investigation it transpired that, the fact that higher growth countries experienced higher investment ratios, higher export volume growth, higher life expectancy at birth, lower inflation rates, and lower standard deviations of inflation did not necessarily imply better terms of trade outcome.

Empirical findings indicating positive relationship are presented below, Contrary to the negative association between government spending and economic growth established by the aforementioned studies, a growing body of literature attempts to redress the balance by suggesting that the state can actually, through implementing appropriate policies, nurture productive activities and reduce unproductive ones; see for instance Amsden, (1989), Epstein and Gintis (1995), also explored the effects of public expenditures on growth among 73 countries over the period 1970-1989 found that the crowding-out and rent-seeking concerns might have been overstated in the literature. According to the evidence obtained, the contributions of public investment and social expenditures to growth is rather significant. Furthermore, Alexiou (2007) in a study for the Greek economy, after disaggregating government spending, reported evidence on the basis of which there is a positive association between the growth in the components of government spending and GDP growth. Aschauer (1990) also documented a positive and significant relationship between government spending and the level of output.

Despite the fact that even the crowding-out literature, has recognised a limited but significant effect of public investment on growth, social programmes have been rendered unproductive, with the exception of education. Thereby, most of the studies conducted have exclusively focused on education as a significant factor which impacts growth through its effect on human capital (Barro, 1991; Roubini and Sala-I-Martin, 1991; Birdsall, Ross and Sabot 1995).

Using the annual data from 1929 to 1996 and a cointegration approach (Johansen, 1988, and Johansen and Juselius, 1990), Islam (2001) provided a strong support for Wagner's hypothesis for the USA. In addition, Kolluri *et al.,* (2000) examined Wagner's law of Public expenditure for the G7 industrialised countries. The study covered the annual sample period 1960-1993 and employed cointegration (Engle and Granger, 1987) and Causality approaches (Engle and Granger, 1987). A major finding is that the long run elasticity of Government expenditure with respect to

national income indicated that Government spending, whether expressed as an aggregate or by type, supports Wagner's law.

Other empirical studies are summarised below. Abimdeh and Yousefi (1998) found that the direction of causality is from economic growth to government expenditure, and is consistent with South Korea's economic status as an emerging industrialised economy, and findings using various public spending components.

In addition, Ansari *et al.,* (1997) used data from Ghana, Kenya and South Africa found no long run equilibrium between government expenditure and national income. Their main findings were that the hypothesis of public expenditure causing national income is not supported by all samples. Ansari (1993) used cointegration analysis and found support for Wagner's hypothesis as a long run phenomenon using Canadian data. Meanwhile, the estimation of error correction model provided evidence to support the Keynesian hypothesis as a short run phenomenon.

The above studies used long run and short run dichotomy to explain the difference between Wagner's law and Keynesian hypothesis. Further, the studies of using disaggregated public spending were conducted extensively by Dhawan and Biswal *et al.,* (1999) and Chletsos and Kollias (1997).

In Nigeria, the economic development has been significant with a high growth and the average growth rate of real GDP, which was 5.4 per cent in the period 1960-70, which rose to 6.1 per cent in 1971-73. The Nigerian economy expanded rapidly, as oil production and export rose significantly. However, activities in the service sub-sector were relatively modest even though marketing and advertising, which covers distributive trade, lagged behind. The average GDP growth rate later dropped to 2.0 per cent during 1976-80 and up again to 3.7 during 1982-90 following improved performance in agricultural and industrial sub-sectors. In the midst of all these development and growth, does the welfare of the citizenry improve?

Suffice it to state that, GDP responded favourably to the economic adjustment policies of the eighties during which the SAP and economic liberalisation were adopted. Thus, annual GDP grew from a negative 0.6 per cent in 1987 to 13.0 per cent in 1990. However, the average growth rate of real GDP dropped to 2.3 per cent during 1991-1998. This was in spite of the favourable developments in the agricultural and services sub-sectors of the economy. Real GDP growth rate rebounded to 8.1 per cent during the period 1999-2007 and hovered around 5 percent to 6 per cent up to 2013, see CBN (2015). This reflects improved economic policy of the neo-liberal or economic reform era. Despite the moderate decline in real GDP

growth rate in the period 2008-2013, the major drivers remained agriculture, wholesale and retail trade, and services sectors. Indeed, the last decade has been a period of rebirth as affirmed by almost all macroeconomic indicators but the growth rate has not been high enough to push down the poverty profile. But the major issue here is whether the growth in the size of the Nigerian economy was predicated on rising government spending and if the same reflects the relationship between government activities and welfare of the citizenry.

The Nigerian economy took a recovery signal from -7.5 percent growth in 1998 to 5.4 percent in 1999 from improved government expenditure. The share of defence and security expenditure was reduced significantly from 23.1 percent in 1970 to 1 1.6 per cent in 1998, At the same time, an increase in the share of both economic and social services were a welcome boost to the economy, According to Mithani *et al.*, (1998), more public expenditure is needed to be allocated for transport, public utilities, agriculture and rural development, education, health and family planning, housing, and community services if we have to experience significant effect of government expenditure especially as regards citizens welfare.

DATA DESCRIPTION AND METHODOLOGY

Data Description
The variables used in analysis are real national income capita (RNIPC) and real Government expenditure per capita (RGEPC). It is worthy of note that the effect of population growth was removed by using per capita values. The sample span covered the period from 1980 to 2012 (33 observations). Data were obtained from International Financial Statistics, International Monetary Fund - CD-ROM). The justification for the using annual data instead of quarterly in the present study is the knowledge that causality is a timely phenomenon, and the interaction of economic variables cannot work in short periods of a few quarters (Tao and Zestos, 1999). The plots of the growth rate of the two variable series were cited in Figure 1 and 2 respectively.
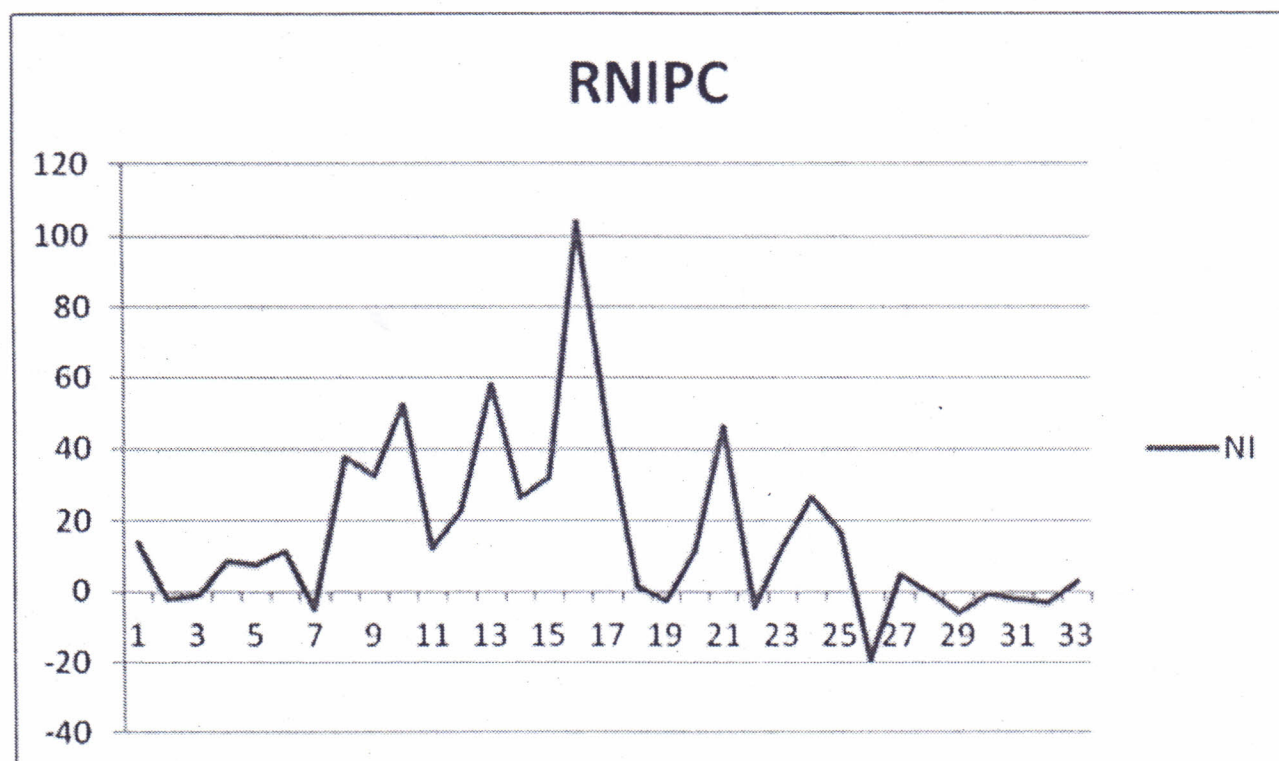
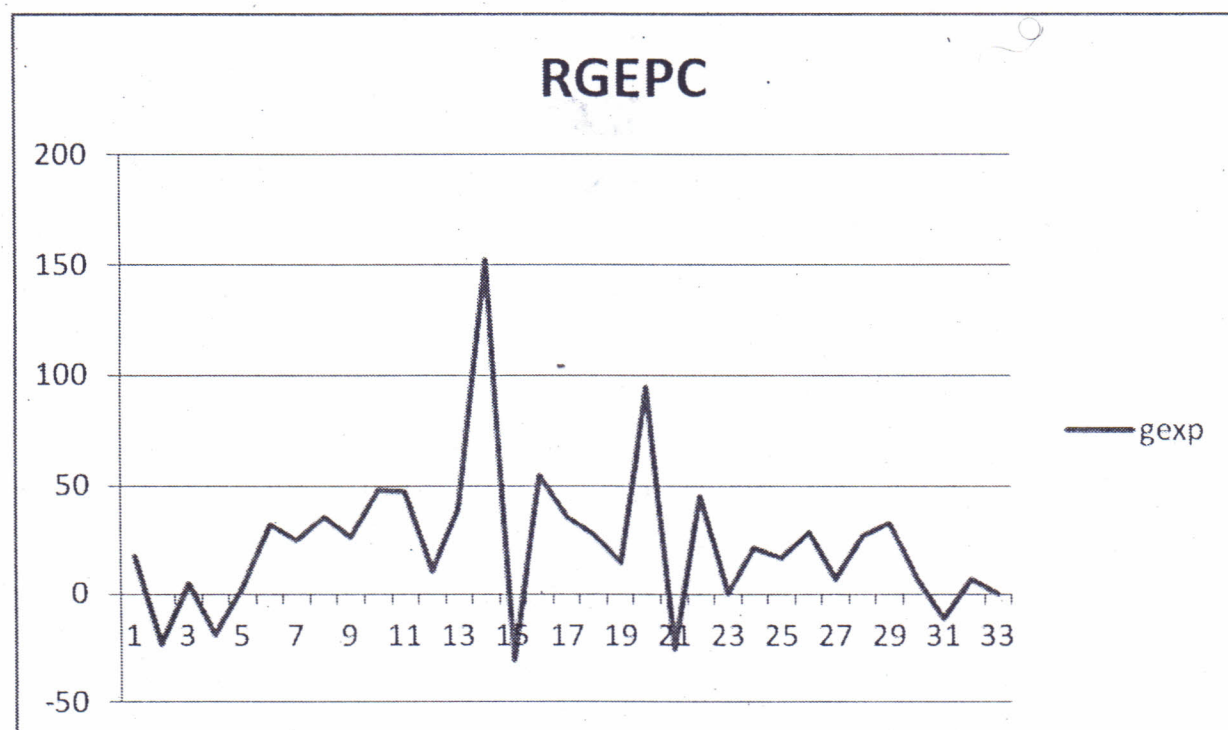**Fig. 1: Growth Rate of Real National Income Capita (RNIPC)**

Fig 2: Real Government Expenditure per capita (RGEPC)

Methodology

Bearing in mind the objective of the study, the granger causality methodology is adopted for this work and thus is presented below; According to Wold (1954) the concept of causality is fundamental to all sciences. He pointed out that a regression relationship may or may not involve a causal hypothesis but the introduction of causal hypothesis makes the analysis more determinate and the resulting conclusion more specific. Feige and Pearce (1979) also argued that the causal relationship between economic variables is the "bread" and 'butter' of econometric analysis.

Johnson and DiNardo (1997), Granger causality or non-causality is concerned with whether lagged values of y do or do not improve on the explanation of x obtainable from only lagged values of x itself. A simple test is to regress x on lagged value of itself and lagged values of y. If the latter are jointly insignificant y is said not to Granger cause x. If one or more lagged value of y are significant then y is said to Granger cause x. They explain further that, the test however, is often very sensitive to the number of lags included in the specification. Changing lag length can result in changed conclusion. In general, it is better to use more rather than fewer lags, since the theory is couched in terms of the relevance of all past information. There is need to pick a lag length that corresponds to reasonable beliefs about the longest time over which one of the variables could help predict the other.

This study will apply Grangers causality model to investigate the direction of relationship between government expenditure and national income in Nigeria. The study is based on two competing hypotheses - production following and finance-leading relationship.

These two hypotheses will be tested using the Grangers causality model. The need to understand the direction of the relation between government expenditure and national income is as earlier stated very important. In this case of study, Y is national income and X is public expenditure.

From the above explanation, our causality model can be written out as

$$RNIPC_t = \sum_{i=1}^{n} \propto_i RNIPC_{t-1} + \sum_{i=1}^{n} \beta_i RGEPC_{t-1} + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots (1)$$

$$RGEPC_t = \sum_{i=1}^{n} \propto_i RGEPC_{t-1} + \sum_{i=1}^{n} \beta_i RNIPC_{t-1} + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots (2)$$

Where National income is represented by $RNIPC_t$ while government expenditure is represented by $RGEPC_t$ all at time t, n indicates the number of observation while ε_t represent the error term assumed to be white noise, this is serially independent with zero mean and finite covariant matrix.α and β are parameters to be estimated t-i is number of lags. i = 1,2,...n.

EMPIRICAL ANALYSIS

Stationarity Test:
Stationarity of a series is an important phenomenon because it can influence its behaviour. If x and y series are non-stationary random processes (integrated), then modelling the x and y relationship as a simple OLS relationship will only generate a spurious regression.

$$Y_t = \propto + \beta X_i + \varepsilon_i$$

Time series stationarity is the statistical characteristics of a series such as its mean and variance over time. If both are constant over time, then the series is said to be a stationary process (i.e. is not a random walk/has no unit root), otherwise, the series is described as being a non-stationary process (i.e. a random walk/has unit root). Differencing a series using differencing operations produces other sets of observations such as the first-differenced values, the second-differenced values and so on.

If a series is stationary without any differencing it is designated as I (0), or integrated of order 0. On the other hand, a series that has stationary first differences is designated I (1), or integrated of order one (1). Augmented Dickey-Fuller test suggested by and the Phillips-Perron test recommended have been used to test the stationarity of the variables.

The stationarity test is below presented;

Table 1: Stationarity Test

Variable	ADF(level)	ADF(1st diff)	Phillips Perron Test (level)	Phillips Perron (1st diff)	Decision Rule
RNIPC	-3.670126	-6.969276	-3.610170	-15.01404	I(1)
RGEPC	1.146811	-4.902426	1.138420	-4.914670	I(1)
Critical values At 5%	-2.960411		-2.957110		

Composed by Author

From the above, it is evident that the two variables used in the model are stationary at 1st difference. Having confirmed the stationarity of the variables, there is a need to establish the term relationship between the two variables either short or long. This is tested and established by johansen cointegration test.

Table 2: Cointegration Rank Test Result

Sample (adjusted): 1985 2011					
Included observations: 27 after adjustments					
Trend assumption: Linear deterministic trend					
Series: RGEPC RNIPC					
Lags interval (in first differences): 1 to 4					
Unrestricted Cointegration Rank Test (Trace)					
Hypothesised			Trace	0.05	
No. of CE(s)		Eigenvalue	Statistic	Critical Value	Prob.**
None *		0.474556	17.37643	15.49471	0.0257
At most 1		5.92E-05	0.001599	3.841466	0.9659
Trace test indicates 1 cointegrating eqn(s) at the 0.05 level					
* denotes rejection of the hypothesis at the 0.05 level					
**MacKinnon-Haug-Michelis (1999) p-values					

Computed by the Authors with views econometrics package

From the above result, the trace test indicates that there exist one cointegrating equation and this confirms the existence of a long run relationship between the variables used in the model.

The causality test result which shows the direction of causality is presented below, the pairwise granger causality tests is used to empirically check the direction.

Table 3: Causality Test Results

Pairwise Granger Causality Tests
Date: 04/11/14   Time: 20:40
Sample: 1980 2012

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
RNIPC does not Granger Cause RGEPC	30	4.42628	0.0226
RGEPC does not Granger Cause RNIPC		0.64966	0.5308

From the above results, it is evident that the causality between the national income and government expenditure in Nigeria is unidirectional and runs from the national income to government expenditure.

This indicates that the level of national income that is obtained in Nigeria stimulate that level of government expenditure. i.e. the money obtained or received by the entire citizenry (firms and household) when it is distributed over savings and consumption will stimulate the level of government spending. This shows that the Nigerian economy exhibits tendencies towards a pronounced capitalist economy even with the overwhelming government involvement in economic activities. That government expenditure does not lead to national income is explained by leakages in government expenditure. These leakages practically limit the supposed significant effect of 'government expenditure'. This indicates that government expenditure often time does not meet the target pre-determined for such expenditure. When capitalist invests, the government catches up by providing infrastructure in order to support the level of investment in the nation. This ultimately will satisfy government objectives and goals in the long-run which is achieving growth and sustainable development but could this mean that a significant proportion of the citizenry is neglected while a few capitalists benefit from government actions. From the result above, we may say that the level of private investment significantly induce national income and consequently welfare. This actually possess a call for further research

5.   Conclusion and Policy Implications

The major concern of this study is to inquire into the relationship between government macroeconomic policy and the outcome of that policy initiative of the government of Nigeria. By extension and by implication the study also tried to

ascertain the validity of Wagner-Keynesian Hypothesis in a developing economy like Nigeria. The results of Johansen cointegration test indicate that there is long run relationship between real per capita national income and per capita real public expenditure over the sample period 1980 to 2012.

Having used real national income per capita as the measure of welfare or macroeconomic policy outcome and public expenditure as an indicator of macroeconomic policy, the results of standard Granger causality tests reveal a unidirectional causality, that is, from real per capita income growth to real public expenditure growth. This implies that the welfare level of Nigerians is not predicated on the size of government spending. This also indicates that Wagner's law is a long run phenomenon in Nigeria. The implication is that as economic activities expand, more Government expenditure is required. However, there is no evidence to support Keynesian proposition that Government expenditure as a policy instrument can be used to encourage growth in the Nigerian economy.

The results here show that although the absolute size of government spending can trigger a rise in absolute size of the economy in Nigeria in accordance with the Wagner's hypothesis as indicated by Nwaogwugwu and Ojapinwa (2015) this may not result to redistributive justice. Hence, whereas government spending may engineer economic growth, the gains from growth may simply be distributed in a skewed manner.

This way, the role of public spending in the Nigerian economy remains a key fiscal policy issue that seriously requires the attention of the government. The government needs therefore, to re-examine its pattern of public expenditure which will essentially derive from a fiscal policy regime that is not overtly and completely market driven.

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