AN ECONOMIC ANALYSIS OF REVENUE AND EXPENDITURE IN NIGERIA, 1970-1998

BY

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DECLARATION

I, AbdulRasheed Zubair hereby declare that to the best of my knowledge, the data contained in this Thesis is from my original research and the Thesis has not been submitted anywhere else for a higher degree or for publication. Literature, information and quotations are indented and their sources are fully acknowledged. The views expressed in this Thesis are mine; so also, the responsibility for any error(s).

Signed _____
AbdulRasheed Zubair

CERTIFICATION

This Thesis titled "AN ECONOMIC ANALYSIS OF REVENUE AND EXPENDITURE IN NIGERIA 1970-1998" written by AbdulRasheed Zubair, meets the regulations governing the award of the degree of Master of Science (Economics) of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This research work is dedicated to the entire members of Alhaji Z. Yakubu's family.

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Alhamdulillahi Rabhil Alamin.

I wish to express my appreciation to many people who have assisted me in various capacities in the course of this study.

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ABSTRACT

Nigeria's fiscal operations since early 1980's have resulted into persistent and huge fiscal deficit. This is attributed to revenue shortfall and rapid increase in government spending. The purpose of this thesis is to undertake an analysis of the relationship between spending and revenue at the Federal level in Nigeria.

Using regression analysis on time series data over the period 1970-1998, the study discovered that oil Revenue, Tax Revenue, Population and wages of the public sector employees are statistically significant in explaining the rapid growth in government spendings which invariably lead to deficit.

The results of the study indicate that oil revenue was the most significant factor. The results show that rapid growth of Federal Government expenditure was caused by persistent deficits. The study recommends that government should embark on policies aimed at raising revenue and reducing expenditure. Restructuring measures aimed at attaining fiscal viability over a long period should be adopted.

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CHAPTER ONE

GENERAL INTRODUCTION

1.1 BACKGROUND OF THE STUDY

High growth and persistence of government deficits have been observed in a number of countries Nigeria inclusive. This unsustainable fiscal deficit causes general Macroeconomic disequilibrium. The persistence of huge fiscal deficit in Nigeria is attributed mainly to the rapid increase in government expenditure and revenue shortfall.

Buchanan and Wagner (1971) postulate that the rapid increase in federal spending is caused by large fiscal deficits. They argue that federal deficit increases federal spending because it reduces the perceived price of publicly provided goods and services. This results in an increase in public spending as long as the elasticity of demand for federal services with respect to the perceived tax price is negative.

Deficit emanates from the rapid increase in spending which does not match up with revenue. Hence the role of public expenditure cannot be over emphasized. In developed countries, it is employed as an instrument in the stimulation of investment activity and economic stability. Significantly, these roles are much very important in the less developed countries (LDCs) such as Nigeria. Public spending play vital role in the creation of infrastructures, encouragement of economic growth in the form of education, health services, transport and communication facilities, growth of capital goods industries, basic and key industries etc. Kwanashie (1981) argued that the public sector in Nigeria has great dominance in the economy and the significance of public expenditure has become so vital that it can be

said that a longer proposition of a country's Gross Domestic Product (GDP) is anchored on the spending decision of the government.

At present, the sources of financing expenditure in Nigeriais is total federally collected revenue which comprises of oil revenue, company income tax, customs and excise duties, value added tax and independent Revenue. Other sources are loans (which can be external and/or internal) and Aids.

During the period of pre-independence (1950-1960) the agricultural sector played a vital role, as the main financier of the country's total expenditure. It is also during that period that Nigeria collected her first external loan amounted to US $28 million to finance capital projects (CBN Statistical Bulletin 1999). The immediate post independence era (1960-1972) is regarded as years of serious expenditures in iron and steel industries, building of so many bridges etc. This period is characterised by continuous fall in agricultural revenue and rapid increase in oil revenue. The growth rate in agricultural sector declined sharply from 2.8% in the 50s to about 0.7% in the 60s through early 70s. By 1968, the oil sector accounted for 1/3 of the total exports (CBN, 1998 Economic Review). Hence, during the period government expenditure rose in excess of the rise in revenue.

In 1986, revenue from oil sector declined again and this resulted in the emergence of the Structural Adjustment Programme (SAP). The policy of SAP aimed at attaining surplus through cutting down of expenditures and to enhance and diversify the country's revenue base.

Development in the world oil market adversely affected federal government finance. Although substantial revenue shortfall was recorded in 1998, there was rapid growth of the

total expenditures.

The actual expenditure exceeded the 1998 budget estimate by 19.9 percent (CBN Economic Review 1998) which was largely attributed to the increase in the cost especially during the fourth quarter of the year as a result of the upward review of salaries of civil servants; increase in expenditures on pensions and gratuities as well as expenditure on political transition to civil rule programme. Thus, total federal government expenditure as a proportion of GDP increased from 11.4% in 1997 to 15% in 1998 (Statistical Bulletin, 1999). Considering the trends in the federal government expenditure, it can be deduced that the rapid increase in government expenditure over the years was due to several factors which include: the rapid growth of oil revenue population increase, increase in wages and per capita income.

The fiscal policy stance of the federal government was highly expansionary resulting in overall deficits of 31 and overall surplus of 6 of the fiscal years between 1961 and 1998. The overall deficits, as a proportion of GDP, ranged from 1.5 percent in 1973 to 9.8 percent in 1974.

This research will concentrate on analysing the causal relationship between revenue and expenditure. It will also find the variable (among the above mentioned variables that determined government expenditure) that best explains the rapid increase in government expenditure with a view to providing possible solution to the problem of fiscal deficit in Nigeria.

1.2 STATEMENT OF THE PROBLEM

The contribution of public expenditure towards economic efficiency, poverty

alleviation and stable long term growth cannot be overemphasised. It is observed that as the nation's economy grows and the level of income increases, the level of government expenses also rises. Indeed, the latter tends to rise more than proportionately than the former (in many underdeveloped countries, Nigeria inclusive).

Failure of the revenue to match up with rapid increase in expenditure has aggravated the problem of deficit. These huge fiscal deficit causes serious ills to the developing countries economies ranging from over indebtedness leading to debt crisis, hyper inflation, and poor investment and growth performance. In the 1990s, fiscal deficits occupied the centre stage in the massive reform programme initiated in developed and developing countries on all confinements (Easterly and Hebbel 1994).

Regardless of the net effects of deficits on the economy, the literature suggests that it has to be feasible or desirable that a country's fiscal deficit profile must be sustainable (Buiter, 1983). Otherwise, the country runs the risk of becoming perpetually insolvent (Wilkens and Uctum, 1990). The Nigerians fiscal deficit as at 1998 stoods at₦ 12.16 billion. The study will address the following questions;

1.What is the major determinant of expenditure in Nigeria?

2.What is the relation between public spending and public revenue?

3.How does this relationship affect the level of deficit?

1.3 OBJECTIVES OF THE STUDY

The purpose of this study is to undertake the following investigations.

1. To evaluate the factors that determine the rapid increase in expenditure which invariably lead to huge deficit.

2 To determine which of the factors (oil Revenue, tax Revenue, population, wages, deficit, per capita income) has higher significant influence in determining the rapid increase in public spending in Nigeria.

3. To investigates how these growth of expenditure has impacted on deficit.

1.4 HYPOTHESIS TESTING

The following hypothesis would be considered in the research.

1. Ho : $a_i = 0$ Government expenditure is not determined by (OR,TR,N,W)

(OR = oil Revenue, TR = Tax revenue, N = population,

W = wages).

H_i : $a_i \neq 0$ Government expenditure is determined (OR,TR,N,W)

2. H_o : $a_o \neq 0$ Fiscal deficit is not determined by (OR,TR,N,W,).

H_i : $a_i \neq 0$ Fiscal deficit is determinined by (OR,TR,N,W.).

1.5 JUSTIFICATION OF THE WORK

Empirical investigations on effects of fiscal deficits in Nigeria has indicated that rapid increase in public spending perpetuates deficits. In addition, researchers have concentrated their attention on public expenditure and economic growth. The study is expected to reveal the main determinant of expenditure in Nigeria which, in turn increases deficit with a view to suggestion ways that can equilibrate revenue and expenditure so that the deficit scenario will be

tackled.

1.6 SCOPE AND LIMITATION OF THE STUDY

The study covers a period of 1970-1998. This period has been chosen for a number of reasons. Firstly, the scope of the study covers the period of deficit, period of fiscal balance and period of fiscal surplus.

Secondly, the period spans across different military regimes and a political democratic era, with their expenditure preference. Lastly, the period was chosen to capture a series of changes in the Nigerian economy in such a way the observations are enough to undertake any econometric analysis.

The main limitation of the study is the limited availability and reliability of statistical data. This study is not an exception. In Nigeria, the inadequacy of quantitative and qualitative data can not be overemphasized. The conceptual problems and the inconsistent method of compiling such time series data further constitute a major limitation on any serious academic research. Despite the above mentioned problems of data, this research hopes to provide reliable and authentic result which can be used for the policy formulation in which the consistency of detailed policy decisions could be tested and also the framework for assessing past performance of the economy.

1.7 SOURCES OF DATA

The data sources include the Annual Abstract of Statistics of various years published by

the Nigerian Federal Office of Statistics (FOS), Lagos. The Central Bank of Nigeria (CBN) publications: Statistic Bulletin; Economic and Financial Reviews; Annual Reports; Quarterly Reports; Statement of Accounts; World Bank Working Papers; and IMF working papers.

1.7.1 TECHNIQUES OF ANALYSING DATA

Analytical and Descriptive techniques have been used in analysing the data. The estimation of the parameters of the models have been done by analytical ordinary least square (OLS) method of estimation and the Granger Causality technique test. Descriptive tools like graphs, tables and percentage have also been be used to analyze data.

1.8 STRUCTURE OF THE WORK

The study is structured into five chapters. Chapter one embodies the general introduction of the research. Chapter two covers the review of the existing literatures, definition of concepts, laws of increasing government expenditure, Development models of public expenditure growth and similar empirical studies. Chapter three contains an overview of trends of government expenditure and revenue in Nigeria. Chapter four is the empirical chapter. Here, the research models shall be specified and estimated results of the findings are interpreted and evaluated.

Chapter five forms summary, conclusion and recommendation based on the findings.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

Public expenditure can be defined as the expenses the government incurs for its own maintenance as well as for the society and the economy as a whole. It also includes the expenses by some governments to help other countries.

Lindaver and Valenchick (1992) observed that governments (of both developed and under-developed countries) have been spending even larger proportions of their national income throughout the twentieth century.

Thus, it was observed that by 1986 government expenditure as a share of GDP has increased rapidly in 82 percent of the developing countries. According to Lindaver and Valenchick, the growth in spending by developing countries has been explained by many factors including ideology, demographics, a positive income elasticity of public goods. Even though public expenditure is found to be continuously increasing overtime in almost every country, the traditional thinking and philosophy have not been encouraging to the growth of the public expenditure. This is because of the fact that many economists believe that the market mechanism should be regarded as a better mechanism by which the working of the economy could be better guided and the allocation of resources better decided. This thinking is usually based on the argument that each economic unit is the best judge of its own interest and government is certainly not able to decide on behalf of others. According to them (Lindaver and Valenchick), the best government is the one which does the least and should allow invisible hands and private sector to play dominant roles in the activities of the economy. Although they argue that government should undertake and involved itself in the provision of matters of state security, administration of justice, provision of certain public works and such like matter.

Contrary to the advocate of laissez-faire, another school of thought emerged with the view that governments can no longer fold their arms and watch the miseries of their people. The idea of public expenditure as a vehicle of economic growth has been accepted by most of the developed and developing countries like U.S.A., Japan, Cuba, Isreal, Brazil, Sweden, etc.

Many studies have been carried out by different scholars on public spending. Several models have been used in analysing the concept of public spending. For the purpose of this study, macroeconomic models will be considered. This is because of its relevance to the theme of this study.

2.2 THEORIES OF PUBLIC EXPENDITURE

(a). WAGNER'S LAW OF INCREASING PUBLIC EXPENDITURE

Propounded by Adolf Wagner (1890), a German economist, the law aims at establishing generalization about government expenditure (such as central and state governments) using historical approach. On the basis of his empirical findings, Wagner formulates the "law of increasing state activities" which states that as per capita income in the industrial nations grow, government spending as a proportion of aggregate output will increase indicating that the income elasticity of public spending exceeds unity. Wagner explained this phenomenon is resulting from the pressure for social progress and the changes in the relative spheres of private and public economy". This can be seen as a result of state participation in material production and provision of certain socio-economic services such as health services and welfare services.

These socio-economic services are income elastic wants so that as real income

increases, public expenditure on them would rise more than the proportion which would account or the rising ratio of government spending to gross national product. Two main issues were neglected by the Wagners law, that is, the issue of revenue constraints on public expenditure growth and the effect of war on the growth and pattern of public spending.

Wagner gave the following reasons for the increasing public expenditure.

i) Traditional functions of the state are expanding: Defence, for example, is becoming more expensive than ever before while within the country administrative set up is increasing both in coverage and intensity as the government machinery has to be manned by experts in their own fields. Similarly, administration of justice is becoming expensive and cumbersome as the society progresses. Increased complexity of population, population density and urbanization would lead to increased public expenditure on law and order and on economic regulation, he argued.

ii) Increase in state in terms of coverage;

With the growing awareness of its responsibilities to the populace, the government is expanding its activities with respect to various welfare measures as, for example, to improve the cultural life of the society as well as those designed to provide social security measures, subsidies for and direct provision of various merit goods and public goods. State activities also increases steadily on account of its efforts at redistributing income and wealth.

iii) Increasing Recognition of the need to provide public goods:

As the need to provide and expand the sphere of public goods is being increasingly recognised, the state is trying to shift the composition of national produce in favour of public

goods and this necessitates the expansion of the investment activity of the government.

According to Bhatia (1985), additional factors which contribute to the tendency of increasing public expenditure include the necessary growing role of the state in the increasing complexities of modern life.

These additional factors demanding further increase in public expenditure are as follow:

i) The population itself is increasing in most cases and thus becomes a major contributing factor to the growth of public expenditure. For example, the scale of various public services has to increase in harmony with the population growth. Thus more schools, hospitals etc have to be provided to meet the extra needs of the growing population.

ii) An increasing movement of people to the urban areas; existing cities thus grow larger while new ones develop. This urbanization trends implies a much larger per capita expenditures on civic amenities. So many goods of incidental services like those in link with traffic roads, etc need to be provided.

iii) There is high possibility of increase in price and this will results to increase in public expenditures.

iv) As the size and nature of public services now involve higher specialization, better services and better qualified personnel (administrators, technicians etc) do imply a higher cost of providing public services. So also, government has to purchase a number of goods and services for its own maintenance; and with rising prices, expenditures on them will also rise.

v) Modern government felt it is its responsibility to protect its citizens from the evils of market mechanism. Thus, anti cyclical and other regulatory measures are adopted. Efforts are also made to reduce income and wealth inequalities so as to ensure social and economic quality as much as possible. Hence, expenditure tends to increase.

vi) Modern governments have a tendency to run into a debt and this leads to a subsequent increase in government expenditure in the form of increasing cost debt servicing and repayment of the loans.

vii) The ideals of planning and economic growth are being increasingly accepted and this means an increase in public expenditure.

Bird (1971) said that even though the ideas of Wagner's

law were formulated in Germany, they were explicitly framed to refer to states in which income was rising as a result of industrialization.

He further stated that as per capita income rises in the industrial nations, their public sector grow in relative importance. In other words, as per capita income rises in the industrial nations, government spending, as a proportion of aggregate output, will increase the income elasticity of aggregate expenditure of public spending exceeds unity. Three conditions were summarized by Bird under which one might expect the law to operate:-

1. Rising per capita income
2. Technological and Institutional changes
3. Democratization of the polity (in the sense of wise political participation).

These so called "law" were simply statement of what Wagner thought ought to happen

as the economy becomes industrialize.

Besides, Wagner viewed the state as having its own distinct preferences and taste quite different from individuals making it. He, therefore, introduced the concept of the "organic state" as a superior individual with a general will of its own.

(b) THE WISEMAN-PEACOCK HYPOTHESIS

This is the second most popular thesis of increasing public expenditure. Propounded by Wiseman and Peacock (1961), their study of public expenditure covered United Kingdom for the period of 1890-1955. This hypothesis emerged as a result of Wagner's failure to recognise the effect of wars or social or political disturbances on the growth and pattern of the Wiseman-Peacock hypothesis (1961).

The hypothesis states that public expenditure does not increase in a smooth and continuous manner but in Jerks and like manner. It further states that, at times, some social and other disturbances take place which, at once, show the need for increased public expenditure which the existing public revenue cannot meet and the citizens of the countries are not ready to pay higher taxes to enable government to have more revenue. Thus according to the theory, while earlier due to an insufficient pressure for public expenditure, the revenue constraint was dominating and restraining and increase in public expenditure, now under changed requirements, such restraints give way. Thus, public expenditure increases and makes the inadequacy of present revenue clear to everyone. The shifting from the older level of expenditure and taxation to a new and higher level in the process is what the authors refer to as displacement effect. The excess of public expenditures as compared with the available revenue

creates the displacement effect. In the process, the authors stressed that government and the people should review the revenue position in order to find solution to the problem and hence argue to the new adjustment to finance the required expenditure. They, therefore, attain a new level of "tax tolerance" and revenue get stabilized at new level until another disturbance occur to cause another "displacement effect". The theory also explain concentration effect which the authors refer to as the apparent tendency for the central government activity to grow faster than that of the state and local governments. Although British data is consistent with these findings, yet it's found that there is a need for proper verification before applying to other countries. In line with this, Bhatia argue that the Wiseman Peacock hypothesis is quite convincing but we must remember that they are emphasizing the occurrence of abnormal situations which cause sizable jumps in public expenditure and revenue. Therefore, public expenditure has a tendency to grow on account of systematic expansion of public activities and also increase in their intensity and quality. This can continue up to the point in which this public expenditure get final need through an ever increasing revenue which is also made possible through structural changes in the economy". Take India and other developing countries as an example, where the state is deliberately trying to increase its activities and make an effort to finance those activities through various tax efforts. He further said that even in developed countries, the states find that it has an increasing regularatory duty towards the economy to protect it against instability and excessive inequalities of income and wealth.

Finally, Bhatia (1985) concludes that "in a number of ways, the market mechanism is not able to pull the economy out of the vicious cycle of poverty and launch it on the sphere of government activities increase and result to corresponding increase in public expenditure"

2.3REVIEW OF EMPIRICAL LITERATURE

Public expenditure is found to be continuously increasing overtime in almost every country be it developed or less developed country. Adolph Wagner (1835-1917), in his thesis on increasing public expenditure, state that there are inherent tendencies for the activities of different layers of government (such as state and central governments) to increase both intensively and extensively. He further argued that there is a causal relationship between growth of an economy and the growth of government activities; and hence, government grows faster than the economy. Wiseman and Peacock (1961) have no problem with the historical contention of Wagner's law but rejected his submission on the cut in increasing state activities. They came up with their own theory which centered around displacement effect and concentration effect which had it basis from their study of public expenditure in the United Kingdom (U.K) for the period of (1990-1955) in which they found that public expenditure does not change in a smooth and continuous manner but in jerks and step-like manner. Over a period of time, there would be some social and other disturbances that take place in which at once show the need for increased public expenditure which the existing government revenue cannot meet.

In essence, Wiseman and Peacock forget that constant and regular increments in public spending are due to some expansion and structural changes in the economy.

Fabricant (1952) conducted a study in which he examined the trend of government activity in United State since 1900. His study concentrated most on the factors affecting state and local government expenditure using multiple regression analysis for the exposition of three variable model that determined the size of public spending that is; income, urbanization and population density. He found that the three factors accounted for about 70% of the variation

in spending; per capital income was the major factor affecting inter-state differences in public spending. Urbanization and population density were found to be less effective. Fisher (1964) decided to increase more variables which include demographic variables and political factors. Fisher's finding was that demographic variable play dominant role in determining the public expenditure growth (i.e, it's the major determinant of public expenditure growth) while socio-political variables gave little explanation on the growth of public expenditure.

Bird (1971) studied Wagner's law in Canada and India. He concluded that expenditure of government as a ratio of Gross National Product has positive relationship with per capita income. He observed that since 1870 the public spending as a proportion of Gross National Product has risen five fold; the greatest factors rose with rising per capita incomes. Rapid increase in expenditure for general administration and protection and in public production such as transportation though substantial, was a proportion of Gross National Product.

Osman (1964) observed the dual impact of federal government aid on states and local government spending. Using regression analysis, he discovered that in both the two instances, i.e. federal government and per capital income were the major determinant of the size of public spending at both the state and local government levels. Also, the federal government grant in aid played a significant role over state government spending. He concluded that federal aid led to increased state government spending while state aid to local government spending raise the combined state and local government spending.

Musgrave (1969) used regression analysis on time series data of Germany, United Kingdom and United States between (1890-1963). He examined the public spending causes in

those countries. His results complied with Wagner's law, although he noted that one cannot predict the course of total public spending during development but only of particular components of the totals. From his findings, he observed a general trend towards a higher ratio of government spending. Through spending on administration increased at over twice the rate of growth of Gross National product (GNP), it remained a small factor in the total spending. It's observed that the ratio for spending on economic service showed faster rise. From the three countries under studies, the main factor of increase was in the social services categories made up of education welfare programme and social insurance and housing for civilian purpose.

Considering the Musgrave results interpretation, it contradicts the wiseman-peacock displacement effect because of the fact that after some post-war adjustments, civilian public expenditure returned to the pre-war trend.

Reddy (1970), in his study, focus on the relationship between secular growth of government spending and National Income of India. He found that the income elasticity of demand for government expenditure was far in excess of unity. He also used regression analysis and discovered that the expenditures of government as a ratio of Gross National Product was positively related to the per capita. He further observed that government spending would increase faster than the national income even if they have excluded price changes and influence of the Indian high population growth.

Philips (1971), using regression and algebraic formulation to enquire whether public consumption expenditure had been following the optimum path in his research on the Nigerian public consumption expenditure (1953-1966), discovered that there was a rising share of

government expenditure as the economy progresses and it showed positive correction between public consumption expenditure and per capita income. He found that Gross Domestic Product (GDP) elasticities of consumption expenditures is very high (three). He asserted that the figure was close to the value obtainable by directly comparing the annual growth rate of expenditure of about 11% during the review period. Hence, this supports the findings regarding a greater than unity national elasticity of consumption expenditure. He recommends that there is a need for higher revenues and better management control of public spending in order to push the national income elasticity of consumption expenditure below unity.

Teriba (1969), using descriptive statistics, in his review of the body of statistical data and history of western Nigeria, found that public expenditure at all levels of administration and decision making in the region rose considerably. His results show that administration and social sectors are the most important sector in the rise of public expenditure. Goffman and Maher (1971) conducted a research on the growth of public expenditure in six Caribbean countries between 1940 and 1965. The results of their study shows a positive relationship between the ratio of public expenditure and Gross National Product to per capita income; and the increase in public spending exhibiting a rachet pattern. They further stated that population, income and price had effect on the growth of public expenditure and also the magnitude of each factor cannot be separated. Goffman and Maher acknowledged the presence of other large unexplained variations in the time pattern. They further opined that foreign influence through national demonstration effect (tied aid programme) had influence on the level of consumption expenditure.

They conclude that the ratchet or displacement effect exhibited is a result of internal

revolution and international trade rather than war or depression.

Koichi (1963) conducted a study in Japan between the period of 1868-1960 and the findings of his research show a positive relationship between the ratio of expenditure to Gross National Product and per capital income. He also found out that solid expenditure is the major determinant of expenditure growth.

Olaloku (1975), in his study on the pattern of public expenditure in Nigeria between 1966 and 1973, has observed that decentralization of public sectors in the country led to expenditure growth due to the following: social, economic and political factors.

Lambo (1987), in his study on federal government spending in Nigeria between 1961-1973; has observed the trend using descriptive statistics. His findings show that recurrent expenditure was fast growing due to the cost of administration and defence services spending during the civil war period which forced expenditure upwards. He also found out that the proceeds from the oil sector in later years had enhanced capital expenditure. Hence, the submission of Lambo is in line with the Peacock and Wiseman's displacement effect.

Olowononi (1981) studied the growth and pattern of public expenditure in old Kwara State between 1968-1976. Using descriptive statistics for his analysis, he found that there had been increase in the growth of public expenditure in the state. This has been attributed to the government commitment to administrative, social and economic services. His results show that government expenditure tends to rise more faster than the gross domestic product. And also social sector spending grow more faster than the average of other item of government expenditure. His study further found that the growth of public expenditure for the period 1968-1976 was due to direct government's involvement in increasing state activity;.

Osoro's thesis (1992) examined public spending, taxation and deficit in Tanzania, using Granger test to arrive at his conclusion.

He observed that Tanzania, like any other developing country has problem of low government revenue with high public spending. This lead to a situation of high fiscal deficits which is so rampant in all the developing countries.

According to Osoro (1992), there are many factors that militate against high growth in government revenue in developing countries, such as low per capita income that limits the direct tax, exemption of earning from agriculture from income tax. And this earning from agriculture is a potential tax base accounting for over 60% of Tanzania's gross domestic product (GDP). While the basis of most taxes remain narrow in Tanzania i.e. increasing at a very slow rate, on the other hand, public spending continues to grow at a very increasing rate surpassing public revenue.

For the past two decades, public expenditure increases at an average annual rate of about 25% compared with 20% for public revenue. This shows that during the period, public spending grew faster than the public revenue. This, according to Osoro, is as a result of low revenue productivity of the tax system and expansionary expenditure policies the government has pursued. Both combining to relate a wide gap between public spending and public revenue that is reflected in high fiscal deficits.

The empirical results show that the perceived tax elasticity with respect to the demand for public goods in Tanzania ranges from 0.53 in the short run and 0.72 in the long run. It also indicate the negative sign for the coefficient of total tax revenue (T) over total public spending (G) i.e [T/G] mean that large deficits have been instrumental in the excessive spending in

dominant role of public sector in developing countries (Tanzania). He accept and support the theoretical proportion put forward by Buchanan and R. Wagner that said Federal deficits increase federal spending.

Osoro (1992) further asserted that an increase in population seem to have increased the unit cost of public goods in Tanzania with elasticity of 1.64 in the long run and 0.23 in the short run. Thus, the coefficient of the population is said to have a positive sign indicating that the growth in population increase the unit cost of public goods in Tanzania.

From the above empirical results, it shows that there is existence of causal relationship between public spending and revenue, population and deficits. In his conclusion, Osoro (1992) recommended that the level of spending should depend on the amount of funds available i.e revenue should cause spending. To achieve the adoption of budgeting process that overcome the problems of existing one and measures to curtail spending must consist of policies designed to reduce deficits. Deficits can be reduced through budget reconstructing, i.e, by cutting unproductive expenditures and enhancing tax collections.

Using Gross National Product (GNP) as a measure of income and expenditure in South Africa, Waasdijk (1964) used descriptive statistics to trace its growth and structural changes over the past three decades.

He observed that in totality, capital expenditure is more flexible than current expenditure and that between 30 and 40 percent of the central government's expenditure consists of fixed or fairly rigid commitments; and that higher increase in government expenditure (current and capital) had its origin in two categories of outlay during the latter half of the forties; health and housing, and education. Also Waasdijk noted that in contrast to

current expenditure which displays a measure of continuity from year to year. Capital expenditure also tends to behave erratically rising or falling, attributing the causes to more of political than economic.

According to him the heterogeneity of income and expenditure items means that even when budgets are perfectly balanced i.e total revenue equals total expenditure and the debt structure remain unchanged, there is tendency that the authorities can exert a marked influence on the country's economic activity. Thus, tax changes and, as such, qualitative variations in expenditure as well as private investment decision affects incomes and indirectly the level of economic output.

Waasdijk's (1964) summarizes his observation as follows: that revenues and expenditures are relative magnitudes so that in times of rising money income, state revenue will increase even if tax legislation remains unchanged. His thesis lack's quantitative approach.

2.4 SOME RELATED LITERATURE ON DEFICIT.

Fiscal deficit were at the fore front of macro economic adjustment in the 1980s in both developing and industrial countries. They were blamed in large part, for the assortment of ills that beset developing countries during the decades like over indebtedness, leading to the debt crisis that began in 1982, high inflation, and poor investment and growth performance. In the 1990s fiscal deficits still occupy the centre stage in the massive reform programme initiated in developed and developing countries on all confinements (Easterly and Hebbel 1994).

Most governments, especially those of the developing countries, often resort to deficit financing. Its persistence and wide spread use is partly attributable by some economists to the

desire of the governments to respond positively to the ever-increasing demand of the populace. There is also the belief that fiscal deficit can stimulate accelerated growth and development (Ariyo 1993). Regardless of the net effects of deficit on the economy, the literature suggests that to be feasible or desirable a country's fiscal deficit profile must be sustainable (Buiter, 1983). Otherwise, the country runs the risk of becoming perpetually insolvent (Wickens and Uctum, 1990, Ariyo 1993).

Despite the consensus on the need to reduce public sector deficits, developing countries offer a bewildering range of experience with deficits. From country to country, deficits may lead to high and variable inflation and crowding out of investment and growth, while in some countries moderately high deficits seems not to generate macro economic imbalances at all.

Many studies have been conducted on indirect effects of public deficit on private investment and consumption. (See Giovannini, 1983). A growing body of evidence from developing countries supports the notion that private consumption is an incentive to real interest rate.

It's also argued that the connection between budget deficits and inflation is evidently complicated. Inflation of triple and more digits is always associated with large deficits, but large deficits do not necessarily lead to inflation (World Bank Report on Public Sector deficit and macro economic Performance 1994). It's often observed that fiscal deficit must not necessarily results to inflation, though it depends on the manner in which deficit is financed.

A research conducted by Durnbusch in 1992 on deficit and inflation in developing countries shows that in a content of developing countries economy, a commercial bank financed government deficit in addition to being inflationary may lead to deterioration of the

balance of payments. Also, financing the fiscal deficit by borrowing externally may increase external indebtedness and raise the burden of future debt service. Where a country is in the throes of external debt service ratio and reduced access to the automatic capitalization of interest rates, external debt service is likely to lead to increased deficit financing through money creation. The tendency will be for the government to issue more money to purchase more foreign exchange on embark on real depreciation in order to improve the external balance. As the stock of the debt becomes larger and the depreciation severer, inflation will become more biting.

Egwakhide (1994) in his studies on Budget deficit and macro-economic management in Nigeria (1994) asserted that, "The unchecked expansion of government expenditure is partly instrumental to the huge budget deficit incurred since the second half of the 1970s in Nigeria. Export instability, together with lack of real control over expenditures are some of the factors. There is also the evidence that the growth of expenditure vastly expanded aggregate demand in the economy due to rigidities, a substantial component of this demand was satisfied from imports. A direct outcome of this is current account deficit which correlates highly with budget deficit, a graphic revelation that external equilibrium is caused by endogenous factors".

According to Buchanan and Wagner (1977), federal deficits increase federal spending because they reduced the perceived price of federal services to the current generation of voters. A reduction in the perceived tax price of federal services in turn would increase federal spending if there is any negative elasticity of demand for federal services as a function of the perceived tax price. Federal spending would increase even if (absolute) elasticity is less than

unity because spending is a product of a unit cost of federal services (which is invariant with the perceived tax price) and the number of units of federal services demanded. Niskanen (1978) tested Buchanan and Wagner theory using American (U.S) data. The approach used was developed independently by Borcherding and Deacon (1972) and Bergstrom and Goodman (1973). Niskanen estimated the demand function for federal services by the average voter-tax payer. His findings has supported the Buchanan and Wagner theory that federal deficits have increased the level of federal spending (-0.61 to 0.56) in short run and long run.

Provopolus (1982) conducted a research on government deficit in Greece, using the model developed by Niskanen. The results of the study support the hypothesis that government deficits increases the level of public spending (-0.16 to 0.28) in both short and long run.

Khan (1988) examined the effect of government deficits on the level of public spending in Pakistan using Niskanen's model. The results also support the Buchanan Wagner hypothesis (0.58 to 0.75) in short run and long run respectively.

Osoro (1992) studied the effect of federal deficit on federal spending using Tanzanian data (1971-1991). He found that, the perceived tax elasticity with respect to the demand for public goods in Tanzania appears to have ranged from 0.53 in short run to 0.72 in the long run. Hence, the findings is in line with the theoretical proposition put forward by Buchanan and Wagner that federal deficits increases federal spending.

In his study on public expenditure and economic growth in Nigeria, 1960-1992 Ekpo found that government expenditure in infrastructures complemented and stimulated private initiatives. Regression results confirmed that public sector investments particularly those on

transport and communications, and agriculture have positive impact on private investment. In aggregate terms, public sector investments crowded in private investments while its changes crowded out private investment. In growth terms, private investment seemed more efficient than public sector investment.

The result also confirmed that private investment benefited from government investment in human capital formulation and the provision of health care. Capital and current expenditures on education and health did not only have the correct signs but the capital components were statistically significant study conducted by Ogiogio on government expenditure and economic growth in Nigeria. His results show that government capital expenditures are no longer productive, not even the capital investment expenditures in the economic and social sectors. The significance of the economic and social sectors recurrent expenditure components points to the need for government to restructure expenditures away from capital investment programmes to the maintenance of existing infrastructure and implementation of policies, especially in economic and social sectors.

In a study of the Nigerian Manufacturing Industry, (Lee 1989) found that the deterioration of socio-economic infrastructure has forced private companies in Nigeria to provide for substitutes. Costly generators have been acquired due to irregular electricity supply. The study shows that there are clear economics of scale in the provision of utilities, communications and social services from which private producers derive enormous benefits. The non-availability or deterioration of these infrastructure due to forced reductions in public investment has imposed heavy costs and shifted resources away from productive private investment in the country. Similar studies in the agricultural sector also found strong evidence

of a very sizeable and significant impact on public investment in irrigation on private sector output response, (Chibber 1988, Binswanger 1988).

(Bleijer and Khan 1984) provides a comprehensive attempt at understanding the impact of different types of public investment expenditures on private investment and growth. The study confirms the hypothesis that investment on infrastructure has a positive effect on private investment and economic growth, whereas non-infrastructure investment has a negative impact. As was observed by Chibber and Dailami (1990), the results of the study are not conclusive because of the absence of a detailed breakdown of pubic investment expenditures.

There are a number of studies which have shown negative effects of public expenditure on growth. Using cross-country econometric results, (Balassa 1988) found a negative relationship between public and private investment separately. The results indicated that public investment had no effect whatsoever on growth. A possible interpretation of their results could be that public investment has no direct growth effect, but only improves the marginal rate of return to private capital. There could also be the existence of strong multi-collinearity between public and private investment which they did not account for.

The study by Shafik (1990) in Egypt found strong evidence in support of the positive impact which investment in public infrastructure yields on private investment. The rebuilding of Egyptian infrastructure had deteriorated sharply in the late 1960s, which had deteriorated sharply in the late 1960s and early 1970s, provided enormous support for the recovery in private investment.

Study conducted by Garba on the determinants of Nigerian Federal Government Expenditure, (1970-1993). The documentation revealed that:

a)Aggregate federal expenditures and its allocation are endogenous and

b)Federal expenditure components were sensitive to:

1. The revealed expenditure preferences of the four regimes that operated Nigerian federal government in 1975-093.
2. The budgeting practices of the four regimes;
3. Exogenous shocks to federal oil revenue and to Nigerian external debt burden and
4. Policy shocks such as exchange rate depreciation, debt rescheduling agreements, debt buy back deals, jumbo loans and so on.

In addition, the documentation suggest seven core propositions of the federal expenditure reaction function:

1 .Federal non-debt capital expenditure (CE) and non-debt recurrent expenditures (RE) are directly sensitive to exchange rate adjustment oil revenue (OR) and non-oil revenue (NOR);
2. Non-debt capital expenditure (CE) was more sensitive to oil revenue shock. Also the effects of oil revenue shock on CE is direct and symmetric;
3. Obasanjo/Shagari's policies raised the burden of debt on post Obasanjo/Shagari federal budgets.
4. External debt service crowd-out federal non-debt expenditure (capital and recurrent) and domestic debt charges (DDC);
5. Depreciation of the exchange rate raises the demand of (EDC) external debt service and (ECR) on federal revenues;
6. Babangida's debt management policies have negative impacts on external debt

service; that is, EDC and ECR: and

7. Obasanjo's Jumbo loan of 1978 and Babagida's exchange rate depreciation of 1986 counteracted the negative effects of negative oil shocks of 1978 and 1986 on non capital expenditure (CE).

2.5 DEVELOPMENT MODELS OF PUBLIC EXPENDITURE GROWTH

Developed by Musgrave R. (1969-1974) and V.W. Roslow (1971). They based their analysis on the fact that there are some different stages in which countries must pass through before they develop or on their process of development. It is also noted that these different stages require varied proportions of government spending. They further stated that in the early stage of development of any country, the ratio of government expenditure to total investment in the economy will be so much. This is because it centred most of her activities on capital formation such as construction of dams, roads, housing telephone, health care, bridge etc in its way to middle stage. In the middles tax although government spending on the provision of these facilities continues but its ratio in the total will be low. Still at this stage the government will concentrate most in complementing the effect of the private sector which is now growing than taking part fully in the provision of all capital investments as in the case of stage one. In his summary, Musgrave state that as the ratio of total investment spending to gross national product (GNP) rises, the ratio of government spending to Gross National Product (GNP) will fall. Rostow further stated that once the maturity stage is reached, government spending on infrastructure will be falling while that of education, health and welfare services will be rising.

The model reflect the structure of developing economies including Nigeria because it shows and explains their gradual movement through various stages with the aim of reaching the prosperous stage.

2.6 DEFICIT CONCEPTUAL DEFINITIONS

Deficit can be regarded as the excess of government's total expenditure over its revenue. This has to be met mainly by borrowing which results to continuous increases in government debt. There can be either structural deficit or a core deficit.

A structural deficit is the balance between total government expenditures and ordinary revenues if, ceteris paribus, the economy were neither in a recession nor a boom, but instead was moving along its "normal" trend. There are other forms of decifits in the literature; current deficit: This is defined as the current expenditure net current revenues. A surplus on this shows that government is using part of the taxed saving of the private sector for its current expenditure needs. It's often preferred if government savings increases (reduces current deficit). Consolidated public sector deficit or the public sector borrowing requirement (PSBR) measures the net use of financial resources by the public sector and hence its impact on the balance of payments, inflation, credit to the private sector and domestic interest rates.

Operational deficit is defined as the PSBR minus the inflation-corrected part of interest payments. With high inflation, the real value of government debt-falls, and a part of the interest payments (which should be deducted) only compensates debt holders for inflation. This is relevant in dealing with high inflation countries. On the other hand, in countries with a large debt overhang, it is useful to measure the non-interest or primary deficit. According to the

International Monetary Funds, Federal deficit is the difference between revenue plus grants on the one hand and expenditure on goods and services plus transfers plus net lending on the other. Alternatively fiscal deficit is the sum of borrowing and net decrease in case holding less amortization.

Although the above definition has received some knocks in the literature, yet, they do not detract it from the main issue, that is how government's decision to spend more than its income has impacted on economic activities.

2.7 THEORETICAL FRAMEWORK

The starting point of the theory of pubic expenditure recognizes the failure of the Market Mechanism to respond fully to the needs of the society. The classical assumes the existence of full employment without inflation. Given wage-price flexibility, there are automatic self in build adjusting mechanism that tend to maintain full employment and produce output at that level. Thus, full employment is regarded as a normal situation and any deviation from this level is something abnormal which automatically tends towards full employment.

Keynes vehemently criticised the classical theory of employment for its unrealistic assumptions. He wrote in his general theory that "the characteristics of the special case assumed by the classical theory happened not to be those of the economic society in which we actually live, with the results of teaching is misleading and disastrous if we try to apply to the facts of experience.... It represent the way in which we should like our economy to behave. But to assume that it actually does so is to assume difficulties away...." (J.M. Keynes General Theory 1936).

Keynes rejected the classical view that the laissez-faire policy was essential for an automatic and self-adjusting process of full employment equilibrium. He pointed out that the capitalist system was not automatic and self adjusting because of the non-egalitarian structure of its society. There are two classes, the rich and the poor. The rich posses much wealth but they do not spend the whole of it on consumption goods. Thus, there is general deficiency of aggregate demand in relation to aggregate supply which leads to over production and unemployment in the economy. This in fact leads to the Great Depression. Had the capitalist system been automatic and self adjusting this would not have occurred. Keynes, therefore, advocated state intervention for adjusting supply and demand within the economy, the rough fiscal and monetary measures.

2.8 THE FISCAL POLICY

This entails the use of fiscal instruments (taxation, Government Expenditure, and Subsidy) in order to achieve the goals of macroeconomics.

Fiscal policy can be expansionary/easy during the period of depression. During this period, government increases its expenditure, reduces tax and increases subsidies.

While during period of inflation contractionary/tight fiscal policy is used. At this time, government reduces its expenditure on public goods, increase the level of taxation and reduce the level of subsidy. Hence, Keynes assert that expansionary fiscal policy can be used to stimulate the level of aggregate demand and output, if the economy is operating at less than full level of employment. In summary government public expenditure can play vital role in influencing level of consumption and investment in an economy which may invariably lead to

economic growth.

On the other hand, excessive government spending may lead to a situation where expenditure supercedes total revenue. Thus, deficit may arise. It is noted that once government recorded deficit, it must look for the way to finance the deficit. This can be either through borrowing (domestically or foreign), or use of foreign reserve to settle the deficit. By borrowing, it means the government has to agree on the terms of payments which usually is attached with strange regulations. Hence, this will perpetuate the deficit as more money will be spent by government on servicing the debt which creates more expenditure and more deficit. Persistence of this may results in high and variable inflation, debt crisis low inflation with crowding out of investment and growth and macro-economic imbalance in general.

The relationship between revenue and expenditure has its theoretical basis from the Keynesian investment multiplier which establishes a precise relationship between aggregate employment and income and the rate of investment (expenditure).

It explains that when there is an increment of investment, income will increase by an amount which is K times increment of investment, i.e. >Y = K>I. The multiplier effect is equal to the reciprocal of one minus marginal propensity to consume (MPC) as shown below;

$$\text{Multiplier (K)} = \frac{1}{1\text{-MPC}}$$

2.9 CLASSIFICATION OF GOVERNMENTEXPENDITURE

Economic and functional classification of government transaction was prepared by the

United Nations Department of Economic and Social Affairs for budget organisations. For transactions consideration, the first manual defined economic classification as organisation by economic categories that are of great importance and quite relevant for analysing the effects of government transaction on the economy. Functional classification was defined as a division by purpose or by functional categories that are significant for analysing the allocation of government resources.

The division are as follows:

a) Administration: This consists of general administration, internal security and defence.

b) Economic service: Included in this category are transport and communication, agriculture, commerce etc.

c) Social; and Community Services: These include sports, housing, water resources, environmental sanitation etc.

d) Transfers: These consists of internal and external debts and other capital requirement and liabilities of government.

The second manual is useful for providing information for decision making. The classification is based on two categories. These are recurrent and capital expenditures.

Recurrent expenditures are the basic element that affects, the level of government services. They are expenditures made for promotion of socio-economic ends and political and cultural system, such as expenditure on staffing and maintenance of schools, government enterprises and government parastatals are all under the same group. Such expenditure is usually for personnel and overhead costs.

Capital expenditure made by government to create development projects. They are also termed capital formation in public sector. Capital expenditures include, investment on plants and machinery, construction works and building and construction of basic infrastructures. The resources needed for capital projects are usually huge. Capital expenditures are very necessary as they enhances growth through creation of employment and increasing the level of existing capital stock. Capital expenditures are divided into four sectors:

1. Administration (Administration and Securities)
2. Economic Service (Agriculture, Livestock, Veterinary, Manufacturing, Transport, Commerce and Rural electrification).
3. Social services (Education, Health, Information)
4. Environmental (Housing, Water).

CHAPTER THREE

3.0 AN OVERVIEW OF TRENDS OF FEDERAL GOVERNMENT REVENUE AND EXPENDITURE

IN NIGERIA

3.1 INTRODUCTION

With the identification of Keynesian economics, government has been using public expenditure as one of the major ways to influence the level of consumption and investment in the economy.

During the years under review, the result of government role in economic activities and the achievements in economic performance in Nigeria have been mixed. The economy experienced growth in real output in some years and decline in others. But the overall picture is that of low scoring of the country's development efforts. The oil boom of the 1970s propelled Nigeria into the class of countries with high per capita income. However, as the oil market weakened and foreign exchange earnings from the dominant sector declined, Nigeria regressed into the group of countries with low per capita income. The economy is also identified with macro-economic instability, huge deficit, and unemployment. These problems have resulted from the continued dependence on the export of crude oil as the main source of revenue of the country.

3.2 TRENDS OF GOVERNMENT REVENUE IN NIGERIA.

3.2.1 FEDERALLY COLLECTED REVENUE

Nigeria's federally collected revenue has been categorised into two main groups i.e. oil revenue and non oil revenue (others). Petroleum receipts accounts for about 75 to 85 percent of the total revenue. On the other hand, the non-oil revenue which comprises up of value added tax (VAT), company income tax, custom and excise duties, federal government independent revenue, AFEM surplus revenue and others accounted for about 25 percent of the total. Table 3.1 shows the total federally collected revenue from 1970-1998.

Federally collected revenue recorded substantial increase while its structure also underwent dramatic changes during the period, 1970-1998, resulting from favourable developments in the international oil market. The federation account revenue increased sharply from N634.0 million in 1970, representing 11.3 percent of GDP to N15,233.5 million or 30.0 percent of GDP in 1980 but dropped thereafter to N12,595.8 million or 17.2 percent of GDP by 1986. The growth in gross receipts was attributable to increases in revenue from both oil and non-oil sectors. However, the oil sector remained the dominant source of foreign exchange earning as well as government revenue from the mid-1970s.

Table 3.1: Total Federally Collected Revenue

Years	Oil Revenue M(₦)	Non-oil Revenue M (₦)

1970	166.6	467.4
1971	510.1	658.7
1972	764.3	640.8
1973	1,016.0	679.3
1974	3,724.0	813.4
1975	4271.5	1,243.2
1976	5365.2	1400.7
1977	6080.6	1981.8
1978	6555.8	2815.2
1979	8880.8	2031.6
1980	12,353.3	2880.2
1981	8,564.4	4,726.1
1982	7,814.9	3,618.8
1983	7253.0	3,255.7
1984	8269.2	2984.1
1985	10,923.7	4126.7
1986	8,107.3	4488.5
1987	19,023.0	6353.6
1988	19,831.7	7765.0
1989	39,130.5	14,739.9
1990	71,887.1	26,215.3
1991	82,666.4	18325.2
1992	164,078.1	26375.1
1993	162,102.4	30667.0
1994	160,192.4	41,718.4
1995	324,547.6	135,439.7
1996	369,190.0	151,000
1997	416,811.1	166,000
1998	289,532.3	174,076.5

3.2.2 PETROLEUM REVENUE

Petroleum revenues are critically dependent upon the relationship between the Nigerian National Petroleum Corporation (NNPC), the Joint Venture Companies (JVC's) and the

Federal government (FGN). Petroleum revenues derive from two source: Export sales and Domestic sales.

Revenue accruing to the federation account from the export is derived from sales less costs less profit for the foreign partners in JVC's (X-C-πFP). From the domestic sales, NNPC does not have to keep any profits and is expected to turn to the federal government all the gross sales proceeds minus a small commission as the agent of the government in JVC, the weak link in this chain is costs. NNPC is supposed to pay a share of exploration and production costs on behalf of the federal government according to the production equity held by the government, approximately 57 percent in 1994. This funding requirement is referred to as "cash calls". The cash calls, which used to be budgeted in terms of barrel per day, are now budgeted in dollars and Naira in the form of first charges on federally collected revenues.

By 1970, Nigeria became a major world net oil exporter and joined Organisation of Petroleum Exporting Countries (OPEC) in 1971.

Since 1970's, the oil revenue became the most dominant and important source of government revenue.

The period 1970-1980 could be seen to represent the oil boom period in Nigeria, both in production exports and earnings. During the period, there was favourable developments in the international market. The contribution of oil to federally collected revenue rose rapidly from 41.4 percent between 1970 and 1972 to 73.9 percent between 1973 and 1979, and averaged over 70 percent for most of the 1980's reflecting largely the high price increases recorded from the mid-1970s, following the drop in world oil supply as a result of the Middle East crisis. The oil shock of 1973 and 1974 brought about substantial windfall in foreign exchange earning. By

1980 the price per barrel of Nigeria's crude oil rose to US $40. Plus, in absolute terms, oil receipts showed persistent increases from a mere N166.6 million in 1970 to N4,271.5 million in 1975 and N12,353.3 million in 1980. But a drastic decline was recorded in 1986 where oil revenue fell to N8,107.3 million.

Oil revenue received further boost from the second half of the 1986 upon the adoption of deregulatory measures under Structural Adjustment Programme (SAP). In 1987 the oil revenue rose at an alarming rate to N19,027.0 million. It further increases to N71,887.1 million, N162,102.4 million in 1990 and 1993 respectively. By 1996 and 1997 the oil revenue continued to increase to N369,190 million and N416,811.1 million. But there was rapid decline of the oil revenue in 1998 due to oil glut in the international oil market where a barrel was sold at US $9, and the revenue stood at N289,523.3 million.

3.2.3 REVENUE FROM THE SALE OF DOMESTIC CRUDE:

In the recent past, revenues from domestic petroleum sales of government owned crude oil to the NNPC refineries have been close to zero because the NNPC has been unable to recover the cost of refining and distribution due to the low refined product prices set by FGN.

The federal government in its quest to raise more revenue domestically, tactically reduced the element of implicit subsidy in the pricing of petroleum products in the domestic market from 1986 to year 2000. The federal government has increased the price of petrol from 20K/per litre in 1986 to N22 per litre in 2000. And this increase, effected substantial increase in other petroleum products.

3.2.4FEDERATION ACCOUNT

Between 1961 and 1969, all federally collected revenue was transferred to the federation account for distribution among the federal and regional governments and later among federal, sate and local governments. During the period, 1970-1986, about 92.2 percent of federally collected revenue was transferred to the federation account and distributed among the three ties of government. However, this ratio dropped to an average of 64.0 percent between 1987 and 1998. This resulted from the introduction of stabilization fund, dedicated accounts and first charges Joint Venture cash calls, creation of a fund to external debt obligations, oil revenue leakages, establishment of Petroleum (Special) Trust Fund, (PTF), dedication of oil lifting for the execution of national priority projectors and other off budget accounts.

3.2.5 OIL REVENUE LEAKAGES:

It is found that not all oil revenues find their way into the federation account. In theory, all petroleum exports royalties and profit taxes should accrue to CBN accounts for conversion into Naira prior to their transfer into the federation account. Some of these revenues, however, have been diverted into dedicated accounts which have been earmarked for priority projects. There is another leakage which is estimated from the value of revenues that should have been collected from the foreign partners in the JVC's and those which were actually seconded by the CBN. This is called "other diversions". These leakages may have been the source funding for "the oil surplus/windfall account" established in 1990 at the outset of Gulf war. One of the largest and most recent off-budget funds, however, is the Petroleum Special Trust Fund

(PSTF) which is financed from the taxes on domestic petroleum sales.

3.2.6 PETROLEUM SPECIAL TRUST FUND (PSTF):

The PSTF was set up in October 1994 to manage receipts into the funds with the objective of financing a lot of capital projects and rehabilitating economic and social infrastructure through out the country. This is meant to bring the benefits of the increase in the prices of petroleum products to the citizenry. For instance, in 1995, nearly one-third of all federally retained revenue, equivalent to N5.32 per litre of domestic petrol sales, came from this new off-budget source. These revenues were controlled by the board of trustees appointed by the government.

3.2.7 DEDICATED ACCOUNTS AND FIRST CHARGE:

Prior to 1995 the federal government had been earmarking a portion of the revenues for various special projects. This was achieved through the creation of off-shore "dedicated oil account". The fund in this account are controlled by federal government but are neither meant to fund cash calls obligations nor deposited into the federation account. These funds and the associated expenditures have not been recorded in the budget or the final accounts shown by the auditor-general of the federation. Although the federal government has not published much data regarding the use of the oil dedicated accounts, it is known that there were, and may still be, at least six accounts. The accounts have usually been budgeted in terms of barrel per day.

3.2.8 STABILIZATION ACCOUNTS:

Basically there are two stabilization funds in operation. They were established in 1989 with the aim of sterilization of excess receipts from oil sales above the budget prices. Proceeds of the fund are shared between 3 tiers of government. No formal rules are documented for deposits and withdrawals, although it appears that access to the fund has been limited primarily to the federal and state level government. The local governments have had a limited resources and special funds have not drawn from the account at all. Deposit at the second stabilization account are set 0.5 percent at all federation account revenues.

Other off-budget account:- There have been other off-budget account in the past such as loss of Naira dominated oil receipt which occur as a result of NNPC drawings from its accounts with the CBN to fund its operational losses and shortfalls. There is also forced borrowing from state and local government. And finally, there is special debt account which was to be used to repay a portion of Nigeria's external debt.

3.3 NON-OIL REVENUE

Non-oil revenue has been categorised into (6) six different headings namely; value-added tax (VAT), customs and Excise duties, company income tax, AFEM surplus Revenue, Federal Government Independent Revenue, and others. (Refer to Table 3.2.

Table 3.2 : Non Oil Revenue (N Million)

YEAR	COMPANY INCOME TAX	CUSTOMS & EXCISE DUTIES	V.A.T. VALUE ADDED TAX	FED. GOVT. INDEPENDENT REVENUE	AFEM SURPLUS REVENUE	OTHERS
	45.0	370.0	-	51.6	-	-
1970	67.5	491.0	-	100.2	-	-
1971	80.4	481.1	-	79.3	-	-
1972	80.8	516.2	-	82.3	-	-
1973	148.8	498.3	-	166.3	-	-
1974	261.1	760.7	-	220.6	-	-
1975	22.2	882.7	-	295.8	-	-
1976	476.9	1145.6	-	339.3	-	1,224.1
1977	527.4	1798.2	-	589.6	-	1,170.0
1978	575.1	1143.9	-	312.6	-	1.7
1979	579.5	1,813.5	-	487.5	-	6,072.1
1980	403.0	2,325.8	-	1,997.3	-	12,853.1
1981	550.9	2,336.0	-	733.8	-	-
1982	561.5	1,984.1	-	710.1	-	-
1983	787.2	1,616.0	-	580.9	-	-
1984	1,004.3	2,183.5	-	938.9	-	-
1985	1,102.5	1,728.2	-	433.7	-	35,000.0
1986	1,235.2	3,540.8	-	407.6	-	31,000.0
1987	1,550.8	5,672.8	-	540.5	-	34,660.0
1988	1,914.3	5,815.5	-	938.0	-	34,778.0
1989	2,997.3	8,640.9	-	1,724.0	-	
1990	3,827.9	11,456.9	-	3,040.4	-	
1991	5,417.2	16,054.8	-	4,903.1	-	
1992	9,554.1	15,486.4	- -	5,626.5	-	
1993	12,274.8	18,294.6	-	3,888.2	- -	
1994	21,878.3	37,364.0	-	20,436.4	-	
1995	22,000.0	55,000.0	7,260.8	3,405.0	-	
1996	26,000.0	63,000.0	20,761.0	8,339.9	-	
1997	33,315.3	57,683.0	31,000.0	11,431.6	-	
1998			34,000.0		-	
			36,867.7		-	
					-	

3.3.1 VALUE ADDED TAX (VAT):

Value added tax was introduced in 1994 to replace sales tax which hitherto generated revenue for state governments. VAT was designed broadly to be levied on imported goods, locally manufactured goods, hold services, bank transactions, etc. It was to be federally-collected. A uniform rate of 5 percent was fixed on all affected items while VAT revenues do not pass through the federation account and are distributed among the three tiers of government. Initially, the federal government received only 20 percent of the VAT proceeds to cover administrative cost of collection, while state and local governments received 30 to 20 percent respectively. The sharing formula of the VAT proceeds has been revised in 1995: the federal government takes 50 percent while state and local government receive 30 and 20 percent, respectively. In 1996, the sharing formula of the proceeds of VAT was revised again to 35:40 and 25 percent to the federal, state and local governments. In 1998 the formula was changed to 25:45:30 percent and finally in 1999 the ratio changed to 15:50 and 35 percent respectively.

Revenue from VAT increases rapidly from N260.8 million in 1994 which represented 3.6 percent of total federally collected revenue to N36,867.7 million or 8.0 percent of the total revenue in 1998. As a proportion of GDP, VAT receipts represented 0.8 and 1.3 percent of GDP in 1994 and 1998 respectively.

3.3.2 CUSTOM AND EXCISE DUTIES:

These are the revenues generated in the form of imports duty and excise duty. From the Table 3.2 it can be seen that the trends of revenue from this sector over the years is

increasing except for the year 1993. The revenue from this sector increased to N18,294.6 million in 1994. By 1996 the revenue rose to N55,000.0 million. By 1987 total sum of N63,000.0 million was realised. The revenue falls drastically to N57,683.0 million in 1998.

3.3.3 COMPANY INCOME TAX:

The revenue from company income tax has been increasing from 1980 to 1998 consistently for instance from the table (2) Appendix. It shows that N579.2 million, N3,827.9 million, N21,878.3 million were realised in 1980, 1991 and 1995 respectively. By 1998 the contribution of the company income tax to the total federally collected revenue rose to N33,315.3 million which represented 7.1 percent of the total revenue. As a proportion of GDP company income tax receipts represented 1.1 percent in 1998.

3.3.4 INDEPENDENT REVENUES

Independent revenues are collected by, and allocated only to the Federal Government. These originate from a variety of sources, including proceeds from privatization, loan repayments from state governments, dividends or profits from public enterprises, the recovery of domestic debt service from the states and some income taxation. It can be seen from the Table 3.2 that independent revenues increased from three per cent of the total federally collected revenue in 1986 to seven percent in 1992 and to five percent in 1993. The sharp increase was derived primarily from N7.3 billion in loan recoveries and N1.65 billion in proceeds from privatization. In 1995 the revenue from this sector has risen to N20,436.4 million. A drastic decline was recorded in 1996 when the revenue fell to N3,407.0 million. The

revenue increased rapidly to N11,431.6 million in 1998.

Others:- This includes the miscellaneous sources of government revenue which didn't fall in any of the above categories of government revenue. The contribution of this sector is not steady. The revenue from this sector has risen from N35,000.00 million in 1995 to N34,778.0 million in 1998.

3.4 TOTAL FEDERAL GOVERNMENT EXPENDITURE

The total expenditure of the government sector is generally analysed in two broad categories of recurrent and capital expenditures.

Before analysing the trends of total federal government expenditure, it is worthwhile to discuss public expenditure policies in Nigeria.

3.4. 1PUBLIC EXPENDITURE POLICIES IN NIGERIA.

The annual capital expenditure programme of the government sector from the early 60s has been guided by multi-year national development plans. Four to five years development plans were implemented in the country between the period 1960 and 1985 and changed to the three year rolling plan in 1990.

The first National Development plan, 1962-68, had a total expenditure programme of N2.2 billion. The public capital expenditure for the plan period was projected at N1.4 billion, although actual capital expenditure amounted to N1.1 billion. The second National Development Plan, 1970-1974, had a total capital expenditure programme of N3.3 billion. At the end of the plan period, actual public capital expenditure for both the federal and state

governments amounted to N2.2 billion. The implementation period was also extended to 1975.

The third National Development Plan, 1975-1980, had a total capital expenditure programme of N30.3 billion which was later revised to N43.3 billion as a result of increased oil revenue.

The fourth National Development Plan 1981-1985, had a total capital expenditure programme of N82.0 billion. The 1981 oil glut was an obstacle and constraint to the proper implementation of the plan. The average level of oil production dropped from a projected 2.2 million per barrel a day (bpd) to an average of 1.4 million bpd during the plan period while the price fell from a projected average of US $40.0 to about US $20.0 per barrel. Against the projected growth of 4.0 percent, the economy recorded negative growth of 2.9 percent per annum.

In 1986, the Structural Adjustment Programme was introduced with the aim of curtaining government expenditure, redressing the basic structure imbalance in the economy, and establish the base for the emergence of a dynamic market-based economy. From 1988, three year rolling plans and perspective planning strategy were adopted within the policy framework of SAP. The objectives of all the aforementioned development plan include reduction in the level of unemployment; reduction of the dependence of the economy on a narrow range of economic activities, increase in national productivity, balanced development, development of technology etc.

3.4.2 TRENDS OF PUBLIC EXPENDITURE IN NIGERIA

The Tables 3a & b show the total federal government expenditure from 1970 - 1998 as well as capital and recurrent expenditures. There was a relative fall in both recurrent and total

expenditure between 1981 and 1983. A fall in capital expenditure has also been recorded from 1981 to 1986. However, with the introduction of structural adjustment programme in 1986 total expenditures, capital expenditure and current expenditures increased continuously up to 1993.

By 1994 sharp decline of both total expenditures and re-current expenditure was recorded. On the other, hand capital expenditure continue to increase. The total expenditure rose to N16,223.7 in 1986, out of which N7,696.9 million was recurrent expenditure and N8,526.8 million was the share of capital expenditure.

The total proportion expenditure of the federal government as proportion of GDP fluctuated from 43.7 percent in 1980 to 26.1 percent in 1985. It further fluctuated between 24.0 and 30.8 percent in 5 years, i.e, 1986 and 1990, and between 16.6 percent and 36.6 percent in 1990s.

3.4.3 RECURRENT EXPENDITURE:

The recurrent expenditure of the federal government increased from N7,696 million in 1986, representing 10.5 percent of GDP. It jumped to N15,646.2 million or 14.4 percent of GDP in 1987 and Maintained a persistent upward trend to a new height of N206,477.4 million or 7.2 percent of GDP at the end of 1998. The persistent increase in recurrent expenditure was attributable to the rise in personnel and overhead costs.

Table 3.3

The functional breakdown of recurrent expenditure (See Table 3.3) showed that between 1971 and 1986, the shares of transfer payments, economic services and social/community services declined to 44.9, 5.9 and 11.6 percent respectively. While that of administration rose to 37.6 percent. The increase in the share of administration resulted from the expansion in recurrent outlays on defence, internal security and general administration. Between 1987 and 1998, the share of transfer payments increased to 56.5 percent while shares of administration, economic services and social/community services declined to 27.4, 5.3 and 10.3 percent respectively. In 1998, the share of transfer payments was 51.3 percent while those of administration, economic services, and social/community services stood at 26.5, 5.7 and 11.0 percent, respectively. The persistent increase in the share of transfer payment was resulted from the rise in interest payments on both domestic and external debts.

3.4.4 CAPITAL EXPENDITURES:

Rapid increase in capital expenditure was recorded between 1974 and 1980 reflecting significant increase in government revenue following favourable developments in the international oil market, capital expenditure increased progressively and peaked at N10,163.4 million accounting or 20.0 percent of GDP in 1980.

Table 3.4

From the Table 3.4, it can also be seen that the period, thus, witnessed a boost in the

provision not economic and social infrastructure such as highways, air and seaports, hospitals, schools, housing, with outlays on economic and social services sectors constituting 54 and 21.8 percent, on the average, while shares of administration and transfers are ranged from 19.9 and 4.0 percent respectively.

The oil glut of the 1980s had a direct negative impact on the revenue of the federal government which, invariably, affected expenditure with falls from N10,163.4 million or 20.0 percent of GDP in 1980 to N6,557.0 million or 12.0 percent of GDP in 1981. Further drastic decline was recorded in 1984 where it falls as low as N4,100.1 million or 6.4 of the GDP. The capital expenditure has risen to N464.7 million or 7.6 percent of GDP in 1985. The table 3b also shows that

the period, 1987 - 89 has maintained a steady increase in capital expenditure which averaged at 6.1 percent of GDP. The shares of economic services, administration and social services also averaged 24.1, 18.1 and 12.7 percent respectively. The period of 1980-1998 was characterized by high growth in capital expenditure in nominal terms. But in real terms, it grew marginally averaged at about 8.4 percent of the GDP except in 1993 and 994 when it represented 13.9 and 12.3 percent of GDP, respectively. The upward trend in nominal capital outlay during the period reflected the high rates of inflation as well as low value of the naira.

Outlays on transfers, especially on debt repayments, constituted an average of 50.1 percent of total. While shares of economic services, administration and social services averaged 29.9, 13.2 and 6.8 percent respectively.

TABLE 4.5: DEFICIT TRENDS IN NIGERIA

Year	Overall Surplus and Deficit as % GDP
1970	8.7
1971	2.6
1972	0.8
1973	1.5
1974	9.8
1975	2.0
1976	4.0
1977	2.4
1978	7.8
1979	3.9
1980	7.7
1981	11.8
1982	5.9
1983	4.2
1984	4.2
1985	11.3
1986	5.4
1987	8.4
1988	6.7
1989	8.5
1990	11.0
1991	7.2
1992	15.5
1993	7.7
1994	0.1
1995	1.6
1996	1.0
1997	-
1998	

3.5 DEFICIT TRENDS IN NIGERIA

The genesis of budget deficit in Nigeria can be traced back to the colonial

administration and the period of great depression. Statistically, the cumulative budget deficit in the three years 1914/1916 was N4.5 million; and about N7.3 million between 1927 and 1931. The reason for the deficit can be associated with the external loans collected which were used to finance certain development projects (e.g. railway construction and other social overhead capital).

On the otherhand, the period of great depression of the 1930s reduced the receipt of the central government due to heavy reliance on trade taxes for revenue generation. Thus, government deflated accumulated reserves to finance its budget deficit. (Philipson, 1947;57, Okigbo, 1965;13).

Huge expenditure was incurred in the early 70s to reconstruct the damages caused by the civil war, Udoji award in 1974, and wasteful expenditures. Thus, with the unchecked expansion in the expenditure, government resorted to budget deficit which accumulated to about N4.7 billion between 1975 and 1978. (1999 Statistical Bulletin).

The fiscal operation was continuously in deficit. For instance, the deficit stood at 4.1, 10.6, 12.4 and 7.9 in 1980, 1986, 1991 and 1994. (Statistical Bulletin 1998). The fiscal operation resulted in a provisional surplus of 0.1, 1.6 and 1.0 percent of GDP in 1995, 1996, and 1997. Since then, the fiscal operations continued in persistent deficit, the overall deficit of N133,389.3 million or 4.7 percent of GDP.

The surplus of 1985 and 1987 were achieved through intensified revenue generation effort and expenditure retrenchment. The emergence of unhealthy trend of deficit in 1998 was attributed to poor oil revenue due to the glut in the international oil market. And the government has developed a high propensity to spend during the oil boom and has been quite

receptive to socio-political pressures. Thus, the central government became a "revenue follower" (Morrison, 1982), to the extent that its expenditure pattern bore little relationship with movements in receipts. This apparent lack of real control over expenditure made it exceedingly difficult for the government to estimate its spending path that generated surpluses in years of high revenue collection (e.g during the period of gulf war in 1990/91).

3.5.1 DEFICIT FINANCING IN NIGERIA

The observed deficit over the years were financed through borrowing from abroad, domestic sources (Banking system CBN) and draw down on reserves.

3.6 BORROWING FROM BANKING SYSTEM AND CBN

From 1971, the banking sector (mainly the commercial and merchant banks) became the major sources of financing government deficits as it accounted for 87.1 percent in 1971, 93.0 and 37.1 percent in 1975 and 1980 respectively. Foreign sources averaged 38.2 percent during the period.

The periods 1981 and to 1990 and 1991 to 1998 witnessed massive injection of funds from the banking sector or system (Mainly commercial and merchant banks) which accounted for an average of 60.7 percent of total deficit financing.

However, between 1991 and 1998 the banking sector provided an average of 94.1 percent of total deficit financing, with the central bank accounting for 87.1 percent. Thus, government reliance on the banking system to finance its deficits in the latter years impacted negatively on macro- economic variables as manifested in high monetary expansion, higher

inflationary pressures, low real growth rate, deterioration in the balance of payments and exchange rate depreciation.

Between the period 1980 - 1998, it is observed that the capacity of state governments to contribute to the development and transformation of the national economy was constrained by low level revenue. Thus, the reverse is the case as the fiscal operation of the state governments were characterized by high dependence on statutory allocations from the federation accounts and concentration of spending on current activities.

The local government fiscal operation in the country is more or less of the same nature with that of state government as it depends mostly on the federation account.

CHAPTER FOUR

DATA AND RESULTS ANALYSIS

4.1 INTRODUCTION

Chapter four provides the models of the study and the regression analysis results.

Model I shows the effect of oil Revenue, population, Tax revenue and wages on total government spending wages on total government spending between 1970-1998.

Model II is a complementary model that shows the effects of population, Tax revenue, oil Revenue and wages on total deficit between 1970-1998.

4.2.0MODEL SPECIFICATION

4.2.1REGRESSION MODEL

The model was adopted from a study conducted by Osoro on public spending, taxation, and deficit in Tanzania (1992). The model has been adapted to suit the Nigerian economy. The final equation and specification of the model of Osoro is shown below,

Ln XCN = Ln α+δLn(T/G)+ λ 1LnY+ΘLn N+η 2LnW.

The equation was estimated by ordinary least squares (OLS), using annual time series data covering the 1965/66 - 1991/92.

The variables used in the model are defined as follows;

XCN = Real public spending

α,η 3,δ,Θ = coefficients

T/G is the ratio of total tax revenue to total public spending

N = Total population of the country

W = Real wages per worker in manufacturing sector

Y = Income per capita

The theoretical justification of the above model is that

(a) The growth in income (Y) is a powerful determinant of the progressive increase in public spending "Friedman's (1972) hypothesis that higher taxes will lead to even greater increase in expenditure. In essence, the theory asserts that the amount of funds available determines the level of spending. The variable is positively related to the dependent variable as such it has to assume positive sign.

(b) The coefficient of the population variable (N) is postulated to have a positive sign, implying that growth in population increases the unit cost of public goods $\pi>1$ implies "crowding out effect". Wagner's theory of increasing state activity postulate that as per capita income in the industrial nations grow, government spending as a proportion of aggregate output will increases indicating that the income elasticity of public spending exceeds unity. One of the reasons given by Wagner for the increasing public expenditure was traditional functions of the state are expanding defence, administration of justice, are becoming cumbersome and expensive because of the increased complexity of population density and urbanization.

(c) The negative sign for coefficient of the variable (T/G) implies that the large government deficit has been responsible for excessive public spending. The theoretical justification is the theory put forward by Buchanan and Wagner that federal deficits increase federal spending.

(d) The coefficient of W is postulated to have positive sign, meaning that an increase in the real annual wage per worker in the manufacturing sector has significant effect on the

increase in public spending.

4.2.2 THE RESEARCH MODEL

As earlier stated, Osoro's model was adopted and transformed to suit the Nigerian economy so as to give result that will guide in policy formulation in the country. Considering the fact that Nigerian economy differs in terms of revenue base with that of Tanzania, some variables are reshaped and some are introduced while some are discarded. In the Nigerian context, the revenue has been categorised into two i.e. oil Revenue and non Oil Revenue. Because of the contribution of oil to the country's total income (about 80%), oil Revenue (OR) has been introduced as a variable in the model. The other sources are confined under tax revenue. Tr as additional variable (TR) as well. All the two variables will assume positive sign. The Wages of the manufacturing sector (W) is dropped from the model. This is because of the low rate of production and the insignificant total number of the workers in manufacturing sector in relation to the total population of Nigeria. In place of the Wages of Manufacturing Sector, we substituted with wages in the public sector. This is because it is assumed to be more significant. Considering the dominance of public sector in the economy, it is also positively related. It is computed by taking the average of the senior and junior workers wages.

Now the model is re-written as follows;

XCN = F (OR,TR,W,N,)

Where XCN = Government Expenditure

OR = Oil Revenue

TR = Tax Revenue

W = Wages of public sector

N = Population

XCN = $\alpha+\Theta$ OR+ λ 4TR+δ W+ß +U_t

α,Θ, λ 5,δ,ß = coefficients

U_t = error term.

The model was estimated by OLS and the estimates were obtained by the use of computer package. For the package use in aris work is econometric view version 2.2 by Hanson (1994).

Unlike Osoro's model were some variables were deflated, this study will use their nominal values. This is because while trying to compute the data (i.e. to deflate it), the data change in such away that if computed it will give spurious result.

Model 2 is deduced from model one to complement it. It is written as;

FD = F(OR,TR,W,N)

FD = In $\alpha+\Theta$In OR+ λ 6In TR+δIn W+ßIn +U_t

Where FD = Fiscal deficit, OR = Oil Revenue, TR = Tax Revenue, W = Wages, N = Population, = α,Θ, λ 7,δ,ß = coefficients, U_t = error term.

Oil Revenue (OR) has an inverse relationship with fiscal deficit i.e. the higher the oil revenue the lower the fiscal deficit and vice-versa. Therefore oil revenue variabe OR will assume -Ve sign.

Tax Revenue (TR). This variable also will assume -Ve sign; because there exist a

negative/inverse relationship between fiscal deficit and Tax revenue.

Population (N). Positive or direct relationship do exist beteen population and fiscal deficit this is based on the fact that as the population increases the demand for social services (public) increaes at an increasing rate. In its attempt to meet the demand of such public goods, government expenditure rise rapidly and results to deficit.

Wages (W); Increase in Wages causes increase in expenditure, which invriably lead to deficit. Therefore the variable (W) will assume positive, indicating its direct relationship with fiscal deficit.

4.2.3 REGRESSION RESULTS AND DISCUSSION OF MODEL I

XCN = 19.079660 + 2.2741.70 OR + 1.49278190 TR

(3.6738520) (0.5103550) (0.4922810)

(5.1) (4.45) (3.03)

+ 1.9355350 N - 0.0203660 W

(0.7478960) (0.170240)

(2.58) (-0.11)

R - Squarred 0.9840680

Adjusted R-Squarred 0.9800850

Prob (F-Statistics) 0.00000

Durbin - Watson statistics 1.8611580.

From the above regression results, we can deduce that the multiple correlation coefficient, $R^2 = 0.98$. This shows that there is high degree of association between the

independent variables and dependent variable taken together. The adjusted coefficient of multiple determination R^2 = 0.98, indicates that 98 percent of the variations in XCN are accounted for by changes in the explanatory variables. From the result, the t-values help to ascertain the degree of confidence in the validity of the parameters estimated. From the values calculated, it appears that the explanatory variables: OR,TR,N, proved to be statistically significant at 5%. The oil revenue (OR) elasticity stands at 4.045. The high elasticity suggest, that growth in income is a powerful determinant of progressive increase in public spending in Nigeria. This conforms with the finding of Provopolus for Greece, Khan for Pakistan and Osoro for Tanzania.

Secondly, an increase in population seems to have increased the unit cost of public goods in Nigeria with elasticity 2.58. This can further be explained that as our population is increasing, the government of Nigeria, consciously, or subconsciously increase its expenditure on public utilities because of the excessive increase in demand. But that does not mean that government is increasing its expenditure based on the population but rather because of the high demand of such pubic utilities. Therefore, we conclude that the relationship between population and public spending in Nigeria is indirect and positive.

Tax revenue assumed the value of 3.22. This proved that it is significant in determining the rapid increase in expenditure. But from the reality of the Nigerian fiscal system, tax revenue is not having much significant effect in determining the rapid increase in government expenditure. In essence, we can say that the link between the tax revenue and public spending in Nigeria is weak.

From the values of wages, it is found to be insignificant in explaining the variation of public

expenditure. This tally with the Nigerian case as less than 15 percent of Nigerians are public sector workers. And up to 1998, the wage increase is minimum compared with the rapid increase in public spending. The Durbin-Watson statistics computed is 1.98 which confirmed the absence of multi collinearity and auto correlation. The intercept coefficient is 19.07660. It explains that change in government expenditure does not have anything to do with explanatory variables.

4.2.4 RESULT OF MODEL II.

FD = 11.098670 - 4.666127 ORE + 0.0884850 TRE - 6.4824720 N

Tratio = (0.4657000) (3.512670) (0.1415900) (1.3060510)

+ 4.977412 W

(-0.554955)

R-Squarred = 0.8840680

Adjusted R-Squarred 0.8800850.

(Refer to table 5 in appendix for the data used in the Regression analysis).

The above results indicated that the adjusted coefficient of multiple determination R^2= 0.88. This implies that 88 percent of the variations in FD are accounted for by changes in the explanatory variables. From the values calculated it shows that the explanatory variables OR is statistically signficant the variable assume the values of 3.5. While TR, W & P are not statistically significant.

Ut assumed a value of 0.02 in the first model. This indicated that the influence of other variables not included in the Model is 0.02 which is very insignificant in explaining the

dependent variable.

On the other hand, the result of the second model showed that Ut stands at 0.12. Though the value of Ut in the second model is higher than that of the first model yet the value of Ut (0.12) is not significant enough to affect the dependent variable.

The result of this second model confirmed the OR and N as the major determinant of public expenditure that lead to fiscal deficit. Although TR proved to be significant at the first model but is found to be insignificant at the second model. This can be explained that, the total tax revenue in Nigeria is very low compared to the total spending and as such it is less significant in determining the length of deficit in Nigeria.

OR, as the major source of government revenue plays dominant role in determining the growth of deficit in Nigeria.

Population increase is found to be very relevant in explaining the growth of deficit in Nigeria.

The result of model I and II revealed that oil revenue is the key variable in determining public spending in Nigeria

between 1970-1998. To confirm our findings, we run causality test between revenue and expenditure. It will also enable us to know wether it is two way causation or a unidirectional relationship that exist.

4.2.5 CAUSALITY MODEL

The study aims at finding the causal relationship between public spending and revenue.

On a prior expectation, the higher the government revenue the higher the public spending and vice-versa.

To detect the presence of causality, Granger causality between economic variables which since has been used frequently in empirical research. This postulated that if a variable (X_t) causes another variable (Y_t), then (Y_t) will be better predicted using the past values of Y_t and X_t together than using only the past values of Y_t alone.

Sims (1972) used Granger's concept of causality to develop a statistical procedure which he used to investigate the causal relationship within two variables system. He showed that (X_t) does not cause (Y_t) if and only if the projection involves only current and past values of (Y_t). In contrast, Roberts and Nold (1985) have shown that Sims causality tests are very sensitive to changes in the functional forms of the regression being used to test the causality relationship among economic variables.

The use of Granger causality test has been recommended by many scholars. See Gewek et al (1983). This is because of its desirable statistical properties. The Granger causality test is presented as follows;

Gt is said to cause Rt if the current value of Rt is better predicted by past values of Gt and Rt than by past values of Rt alone.

$$R_t = ro + \sum_{j=1}^{m} aj\, G_{t-j} + \sum_{i=1}^{i} bi\, R_{t-i} + et \quad \ldots\ldots\ldots\ldots\ldots (1)$$

$G_t = g_o + \Sigma r\ G_t - i + \Sigma\ \delta j\ R_t\text{-}j + U_t$ ..... (2)

i=1 j=1

From the above model; Rt = Revenue, Gt = Government Expenditure.

Also R_t and G_t are two stationary series

i and j are the lag length

G_t and T_t are mutually uncorrelated white noise series, So that, E (et Es) = E (Ut Us) = 0 for all t and S.

g_o and ro are the intercepts.

M is the maximum number of lags.

Dealing with regression models 1 and 2, if the null hypothesis that $\Sigma_a$js for j = 1,2 ..... M, are jointly equal to zero and if found not to be then can be rejected, then Gt causes Rt in Granger sense similarly, if the δj are not jointly equal to zero, then R_t causes G_t. The acceptance of the null hypothesis αj = δj = 0 (j=1,2..... M) implies that there is lack of causal relationship between G_T and R_t, just as the acceptance of δj - 0 implies that Rt does not cause Gt. Thus, the definition that G_t causes R_t requires that R_t does not cause G_t.

The null hypothesis is to be tested at 5% level of significance.

4.3 STATIONARITY TEST

Running Granger causality test requires that the series R_t and G_t must be stationary in order to avoid spurious results. To test for stationarity, a number of statistics have been developed. However, there are two methods that are commonly used to test for stationarity. They are as follows:

i)Dickey and Fuller (DF) test

ii)Augmented Dukey and Fuller test (ADF)

Dickey-Fuller (DF) test has more limitation because it is associated with the existence of auto-correlation in the error term of the (General) equation which results to a bias in the test. Because of the limitation of DF test this study applies ADF test.

To test for stationarity of data using Augmented Dickey-Fuller test, the observations are firstly tested at levels. To know whether the data is stationary, we compare the values of ADF test statistics with the Mackinnon critical values. If the results shows that the ADF test statistics is lower than the Mackinnon critical values at choosing level of significant, say 5%, then we accept null hypothesis that the data is not stationary at that level. Therefore, first differencing has to be taken if the ADF test statistics is higher than the Mackinnon critical values; we reject null hypothesis and accept alternative hypothesis and conclude that the data is stationary. In case the data is not stationary after the first differencing, we have to keep on differencing up to the point where the ADF test statistics is higher than the Mckinnon critical values. On the issue of differencing, it is noted that the more the number of differencing the more the data is loosing degrees of freedom.

In running DAF test (unit root test) we estimate the unrestricted equation.

$X_t - X_t\text{-}1 = \alpha + ß_t(P\text{-}1)X_{t\text{-}1}+\alpha P_{t\text{-}2}+e_t$ and unrestric regression.

$X_t\text{-}X_t\text{-}1 = X + \alpha P_{t\text{-}2}+e_t$

We calculate the F ratio to test whether the restricted holds (ß = 0, ß=Q).

F statistic ratio is calculated as

$$F = (N\text{-}K)\ \frac{ESS_R\text{-}ESS_{UR}}{Z(ESS_{UR})}$$

Where ESS_R - ESS_{UR} = Sum of squared residual in the restricted and unrestricted respectively.

N = Number of observation

K = Number of estimated parameters in the model

q = Number of parameter restriction.

To conduct the ADF test, the sample size for the timer series must lie between 25 and above.

4.3.1 DICKEY FULLER RESULTS AND DISCUSSIONS

Before undertaking Granger causality tests, a unit root test was carried out to determine whether R_t and G_t are stationary. The unit root test results are presented in the tables below: 4.1 - 4.4.

Table 4.1

Augmented Dickey fuller test equation

Dependent variable is D(EX)

Sample (Adjusted):1972:1998.

Included observations; 27 after adjusting endpoints

Variable	Stage	ADF Test Statistic	At 5% Mc-Kinon Critical values	
Expenditure	Level	-3.9083	-3.6027	S

Table 4.2

Augmented Dickey-Fuller test equation included observations 25 after adjusting end points.

Sample (adjusted):1974 - 1988
Dependent Variable is D (REV).

Variable	Stage	ADF Test Statistic	At 5% Mc-Kinon Critical values	
Revenue	Level D1 D2	-1.1792640 -3.748440 -3.0993130	-3.5867000 -3.5943000 -3.6027000	NS NS S

From the levels of the series of Revenue in table 4.2, it could be seen that the values of reported ADF test statistics are lower in absolute terms than the Mckinnon critical values. Thus, the null hypothesis that the variable random walks can not be rejected. Of the first differences, the values of ADF test statistics are still lower in absolute terms than the Mackninnon critical values. Therefore, the null hypothesis that the variables are random walks can not be rejected. After the second differences, the ADF test statistics produce significant values of revenue which is higher than Mackninnon critical values at 5 percent level of significance. Thus, we conclude that second differencing produces stationarity for the value of revenue.

From the level of the series of expenditure in table 4.1, the ADF test statistics is higher in absolute terms than the Mackinnon critical values. Thus, we conclude that the series is stationarised at level.

Table 4.3

Augmented Dickey-Fuller test equation

Variable	Stage	ADF Test Statistic	At 5% Mc-Kinon Critical values	
XCN ORE	Level	4.646281 -	-3.5867	S
	D2 2nd Lag	3.8062140	-3.6027000	S
TR	D1 3rd Lag	-5.2661850 -	-3.6027000	"
N	D1 2nd Lag	3.6475680	-3.5943000	"
W	D1 2nd Lag	-5.8188380	-3.6027000	
FD	Level	-5.3269610	-3.5867000	

From the levels of the series in Table 4.3, it could be seen that two variables XCN and FD produce significant values, as the ADF test statistics are higher in absolute terms than the Mc Critical values; and, as such, they attained stationarity. After the first differencing with second lagging additional variables, N, and W assumes ADF test statistics which is quite higher than the Mc Critical values. Thus, it is stationarised. After the second differencing and the second lagging the ADF test statistics produces significant values on OR which is higher than the McKinnon critical values at 5% level of significance. We, therefore, conclude that after the second differencing all the variables in the model are stationarised. (Refer to table 5 and 6 in appendix).

4.3.2 CAUSALITY TEST RESULT AND DISCUSSION

Table 4.4: Pair wise Granger Causality Tests Sample 1970/1998 Lagos

Null Hypothesis	Obs	F-Statistics	Probaility

Exp. does not Granger Causes Revenue	28	0.2838700	0.000021
Rev. does not Granger Causes Exp.	28	6.384600	0.042351

Table (4.4) above presents the results of the Granger causality test between Expenditure and revenue. Two null hypotheses were tested to determine the existence and direction of the causal link. The above result showed the relationship between expenditure and revenue to be unidirectional, i.e Revenue causes expenditure. These findings conform with the theoretical basis i.e. Friedman's (1972) hypothesis that the higher taxes lead to even greater increases in expenditure.

The finding also is in conformity with the trends of government revenue and expenditure in Nigeria. For instance, the windfall from oil boom of the 1970s have provided the needed revenue for the direct government involvement in the economy. Government took active participation in social over- heads (infrastructures, roads etc). In essence, the government used the growing revenues particularly to finance increased expenditures.

It can also be seen that by 1980s when the revenue had reduced drastically due to the oil glut at the international oil, market government expenditure was also slightly reduced. In the 1990's, government expenditure increased as the revenue increased, except for 1998 when the revenue declined while expenditure continue to rise (Refer to table 5 appendix). In conclusion, public revenue, to a great extent, causes increase in public spending. The second segment results show that there is no evidence of causal relationship running from expenditure to revenues. These results call into question the theoretical literature that increases in expenditures lead to

increases in taxes. In relating the finding to the Nigerian situation, it can be seen clearly that government expenditure does not bring about increase in revenue because of the fiscal indiscipline and some rigidities in the economy. (Refer to table 4 in the appendix for the data used in computing the Granger test).

4.4 IMPLICATION OF RESULTS/RECOMMENDATION

The result of the study confirmed the Wagner's law of increasing state activity. Although Wagner's law was explicitly framed to refer to industrialized countries, yet the result proved that the law is as well applicable in Nigeria. The result conform with the findings of provapolus for Greece, Khan for Pakistan and Osoro for Tanzania, using the same model. The finding supports the study results of Fisher (1964) on the United States. It also supports the study on old Kwara State by Olowononi (1981).

The Granger causality result shows unidirectional i.e. revenue causes expenditure and not vice-versa. This means that the transmission mechanism of multiplier through public expenditure is ineffective in the Nigerian context. This can be attributed to several factors which include; high expenditure on imports goods, low capacity utilization, institutional rigidities and the Nigerian factor. The test indicated that as government revenue increases, public expenditure increases.

CHAPTER FIVE

5.0 SUMMARY AND RECOMMENDATION

5.1 SUMMARY

This Thesis examined the persistent and undesirable fiscal deficits in Nigeria which has caused by rapid increase in government expenditure. The research aimed at detecting which of the following factors (population, oil revenue, tax revenue, wages, fiscal deficit) best explains the high variation of public spending in Nigeria. The work has been classified into chapters with each concentrating on definite goal. The results of the econometric analysis can best be summarised as follows:

(1) The first regression equation showed that oil revenue, population, Tax revenue are significant in determining rapid increase in public expenditure. Wages was found to be insignificant. The R^2 of 0.98 shows that there was high degree of association between depended and independent variables. On the other hand, the result of the Regression model II (complementary model) showed that oil revenue (OR) was significant in determining the length of deficit (inverse Relationship), While tax revenue, wages and population were insignificant.

2. Causality test was conducted between Revenue and expenditure, the result indicated that, there existed a unidirectional relationship between Revenue and Expenditure i.e. Revenue caused expenditure and not vice-versa.

3. As it is in the literature, before teting causal relationship between variables the data

must be stationary in order to avoid spurous result. The stationarity test for expenditure and revenue was conducted and the result showed that expenditure was stationary at level. The Revenue data was found to be non stationary at level and first differencing, but after the second differencing it was stationary for the values of revenue.

4. The implication of the above results is that oil revenue was the major determinant of rapid increase in public expenditure, and dwindling nature of oil market caused huge fiscal deficit. It is also observed that investment in the public sector was not productive to yield adequate revenue to the nation as it was supposed to be. This was because of the existence of some certain rigidities as discussed in this Thesis.

Tax revenue, wages, population were computed and the results implied that oil revenue was the major cause of rapid increase in government expenditure which invariably lead to deficit.

(i) Tax revenue and population proved to be significant in determining the variation in public spending in Nigeria. But the complementary model indicated that only oil revenue was significant. All the other variables were not significant enough to cause rapid increase in government expenditure.

(iii) Granger causality test was conducted and results showed that there existed a unidirectional relationship between revenue and expenditure and not vice-versa.

5.2 CONCLUSION

In conclusion, within the realms of the theories, it is acknowledged that expenditure can serve as an engine of economic growth especially in developing countries like Nigeria.

Since the oil revenue is the major determinant of public expenditure in Nigeria, it is worthwhile to diversify the revenue base of the government especially the non-oil sector, so as to stimulated expenditure, especially where there is oil glut in the international oil market. Finally the government have to restructure its expenditure strategies in order to have a meaningful economic growth.

5.3 POLICY RECOMMENDATION

Based on the findings, a set of policy decisions that can enhance and improve revenue and curtail the huge deficit is recommended.

1. Government should embark immediately on the expenditure retrenchment. It should also embark on expenditure restructuring. Expenditure restructuring is a medium to long term policy measures aimed at attaining fiscal viability over a long period. It entails shifting expenditure away from less preferred sector to more preferred ones, prioritizing the expenditure programme and privatising economic activities that the private sector can efficiently provide. This will enhance the objective of minimizing the budget deficit. Expenditure restructuring requires a comprehensive study of the economy in order to identify areas of waste and, setting economic priorities. This process can be handled through a national development plan or rolling plan.
2. Government should make provision for efficient utilization of human resources in the country, and should embark on population control. Government should also create the enabling environment for the majority of the labour force to be self dependent. Although there were various attempts by different regimes towards bringing youth into

productive activities, like National Directorate for Employment (NDE), Family Economic Advancement Programme (F.E.A.P), peoples bank the end result was not impressive. Considering the fact that majority of the population are farmers, government should make adequate arrangement on how to acquaint them with new techniques of farming and to provide them with subsidy on agricultural implements. Substantial portion of the labour force, especially the literate ones in the urban areas should be trained through the ideal industrial training centre (I.T.F) to acquire technical knowledge on various craftsmanship. This will boost the industrial sector of the economy and generate more revenue for government. Effective population growth control is necessary because no matter the effort of government in stabilizing the economy, rapid population growth at geometric rate will offset government effort and expenditure will continue to rise.

3. Government should continue to create the enabling environment by investing in economic services especially in the areas of manufacturing sector, construction, large scale irrigation projects, transportation, communications as well as providing other utilities like electricity and water. In essence, the quality of government investment in infrastructure complements the private sector and implicitly enhances growth (Ekpo 1992).

4. Tax administration should be addressed to enhance economic growth. Government should aim at achieving macro-economic stability in order to enhance savings and investment which are prerequisites for capital formation and economic growth. Government should aim at achieving macro-economic stability in order to enhance

savings and investment which are prerequisites for capital formation and economic growth. Given the considerable success achieved through the central administration of VAT, there are potentials that a federally coordinated effort in the administration of personal income tax would yield similar results. However, there is need to ensure that the distribution of the revenue does not encourages each state government.

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APPENDICES

Table 1: ESTIMATION OF REGRESSION RESULT

Years	XCN(M)₦	ORE(M)₦	TR(M)₦	N(M)	W(₦)
1970	903.9	166.6	467.4	56.6	4917
1971	997.2	510.1	658.7	57.4	4917
1972	1463.6	764.3	640.8	58.1	4917
1973	1529.2	1016.0	679.3	59.2	4917
1974	2740.6	3724.0	813.4	61.3	4917
1975	5942.6	4271.5	1243.2	62.8	5541
1976	7856.7	5365.2	1400.7	63.4	5541
1977	8823.8	6080.6	1961.8	63.8	5550
1978	8000.0	6555.8	2815.2	64.1	5550
1979	7406.7	8880.8	2031.6	64.4	5790
1980	14968.5	12353.3	2880.2	64.2	5886
1981	11413.7	8564.4	4726.1	66.8	5961
1982	11923.2	7814.9	3618.8	68.4	6306
1983	9636.5	7253.0	3255.7	70.7	6306
1984	9927.6	8269.2	2984.1	23.0	6306
1985	13041.1	10923.7	4126.7	75.5	6306
1986	16223.7	8107.3	4488.5	77.9	6306
1987	221018.7	19023.0	6353.6	80.5	6306
1988	27749.5	19831.7	7765.0	83.2	12168
1989	41028.3	39130.5	14739.9	84.9	12168
1990	60268.2	71887.1	26215.3	86.7	12168
1991	66584.4	82666.4	18325.2	88.5	18143
1992	92797.4	164078.1	26375.1	91.0	29629
1993	191228.9	162102.4	30667.0	94.1	33415
1994	160893.2	160192.4	41718.4	99.8	39826
1995	248768.1	324547.6	135439.7	99.5	45433.5
1996	288994.6	369190.0	151000	102.3	45433.5
1997	356262.3	416871.1	166000	105.2	45433.5
1998	443563.3	289532.2	174076.5	108.2	45433.5

Source: Statisticl Bulletin December, 1999.

Table 2

ESTIMATION OF CAUSALITY BETWEEN REVENUE AND EXPENDITURE IN (m)₦

Years	Revenue	Expenditure
1970	634.0	903.9
1971	1,168.8	997.2
1972	1,405.1	1,463.6
1973	1,695.3	1,529.2
1974	4,537.4	2,740.6
1975	5,514.7	5,942.2
1976	6,765.9	7,856.7
1977	8,042.4	8,823.8
1978	2,371.0	8,000.00
1979	10,912.4	7,406.0
1980	15,233.5	14,968.5
1981	13,290.5	11,413.7
1982	11,433.7	11,923.2
1983	10,508.7	9,636.5
1984	11,253.3	9,927.6
1985	15,050.4	13,041.1
1986	12,595.8	16,223.7
1987	25,380.6	22,018.7
1988	22,596.7	22,749.5
1989	53,870.4	41,028.3
1990	98,102.4	60,268.2
1991	100,991.6	66,584.4
1992	190,453.2	92,797.4
1993	192,769.4	191,228.9
1994	201,910.8	160,893.2
1995	459,987.3	248,768.1
1996	520,190.0	288,094
1997	582,811.1	356,262.3
1998	463,608.8	44,563

Source: Statistical Bulletin, December 1999.