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Oil Revenue, Government Expenditure and Economic Growth in Nigeria: 1980-2016

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Abstract

This paper analyses the link between oil revenue, government expenditure, and economic growth in Nigeria over the period from 1980 to 2016 empirically leaning on the model employed by Al-Qudair (2005). The study utilizes time series secondary data using econometric techniques which included cointegration, Vector Error Correction Model (VECM), and Granger causality to determine the direction of causality and the magnitude of impacts of the variables. The stationarity of the variables was tested by conducting the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests. The results, as presented in Table 4.1 showed strong evidence(s) that all the variables were integrated of order one, that is, I(1). Findings from the analysis revealed that oil revenue Granger caused both of total government spending and growth, while there was no-causality between government spending and growth in the country. We therefore recommended that government should increase spending on capital projects as well as intensify efforts at increasing output in the oil sub-sector in order to boost economic growth in Nigeria.

Keywords: Co-integration, Economic Growth, Oil Revenue, Public Expenditure
JEL Codes: 011, 013, 047.

1. Introduction

In Nigeria, the impact of oil revenue on government expenditure and economic growth should be significant, given its huge contributions to government spending and the impact on economic growth (Olaniyi, 2001). In addition, oil revenue has been the engine of growth in the economy since 1970. The oil boom in the 70s influenced significantly the fortune of the Nigerian economy, through the massive earnings in foreign exchange from oil (Wafure, 2001). Nigeria responded to the first oil windfall by increasing its expenditure more than revenues, and when the oil market weakened in the early 1980s, export earnings fell. With the general world-wide economic recession and the consequent drop in crude oil prices, the level of external reserves has grossly inadequate in terms of meeting the demands of the economy (Adam, 2001).

However, the problem of effective and efficient utilization of revenue from oil production may retard the realization of economic progress. Before oil exploration began in Nigeria in 1908 by a German company, Nigeria's agricultural and mineral resources provided food, raw materials and export commodities. These important sectors generated income, government revenue and foreign exchange used in the provision of infrastructure for national development, social services which enhanced the quality of life (Olaniyi, 2001). From the early 1970s till date, revenue from oil has continued to dominate every segment of life in Nigeria. Not only has oil provided over 95% of the foreign exchange and contribute over 85% of

government revenue, it has also influenced politics, education, industry, agriculture, culture and arts, even religion.

Again, the volatility of international crude oil price either upward or downward has implications for the aggregate revenue profile of Nigeria, as well as its public expenditure and economic growth. A reduction in the international per barrel price of crude oil would spell a continuous fall in the aggregate revenue profile while a rise would increase the revenue aggregate. Again, the Dutch disease is staring Nigeria in the face as history has proven that a country's natural oil reserve level could deplete to zero. Many studies on Nigeria's economic growth have been devoted to the link between economic growth and government spending (Essien, 1997; Aregbeyen, 2006; Babatunde, 2007; Ighodaro & Oriakhi, 2010; Oyinlola & Akinnibosun, 2013). The discourse from these studies is that either government expenditure impacted on growth or both variables Granger-caused one another.

It has been observed that many of the oil resource-rich developing countries have achieved little more than transient resource booms. Their economies expand rapidly when their resources are reaping windfalls or when there are resources to be exploited; but they contract after the windfall or when the resources are exploited (Adam, 2001). It argued that progress made by the country particularly in the area of infrastructural development is attributed to the ostentation of the oil boom (Olaniyi, 2001). Oil revenues have been, and continue to be, economically important in Nigeria, but their effective and efficient use on economic growth may not be realized.

What are the implications of oil revenue for government spending and economic growth? We asked this question because oil revenue is an important revenue source that can be used to finance economic growth and development.The purpose of this paper is to examine the impact of oil revenue on government expenditure and economic growth in Nigeria. The paper is divided into six sections. After this introduction, section 2 is literature review and theoretical framework. Section 3 contains methodology and model specification and section 4 is results and discussion. Section 5 is the conclusion and section 6 draws the recommendations.

2. Literature Review and Theoretical Framework

Observing that crude oil has been a major source of revenue, energy and foreign exchange for the Nigerian economy, Odularu (2008) analyzed the relationship between the crude oil sector and the Nigerian economic performance. Finding revealed that crude oil consumption and export have contributed to the improvement of the Nigerian economy. Thus, the study concluded that government should implement policies that would encourage active private sector participation in the crude oil sector in the country.

Adedokun (2012) examined the effect of oil export revenue on economic growth in Nigeria between the period of 1975 and 2009. Empirical analysis from the study suggested that oil export revenue had a positively significant effect on growth both in the short-term and long-term in the country. The study further revealed that the primary determinant of foreign exchange earnings in Nigeria was changes in the world crude oil prices.

Akinlo (2012) assessed the importance of oil in the development of the Nigerian economy over the period 1960 to 2009. Empirical evidence showed that oil could cause other non-oil sectors to grow. However, oil had adverse effect on the manufacturing sector. Findings revealed bidirectional causality between oil and manufacturing, oil and building and construction, manufacturing and building, and construction, manufacturing and trade and services, and agriculture and building and construction. It also confirmed unidirectional causality from manufacturing to agriculture, and trade and services to oil. However, the paper found no causality between agriculture and oil, likewise between trade and services and building and construction. In conclusion, the

study recommended appropriate regulatory and pricing reforms in the oil sector in order to integrate it into the economy, and as well reverse the negative impact of oil on the manufacturing sub sector in Nigeria.

Oladipo and Fabayo (2012) investigated global recession and the oil sector, based on its effects on economic growth in Nigeria. Analysis from the study revealed a negatively significant relationship between GDP and oil produced (domestic consumption and export) in the country. The result also showed the existence of a decline in the oil sector due to global recession. The study, therefore, recommended deregulation of the oil sector for efficient performance, and more rigorous policies that will reduce global effects on the sector as it contributes the largest percentage of income to the Nigerian economy.

In Iran, Farzanegan (2011) analyzed the dynamic effects of oil shocks on different categories of the Iranian government expenditures from 1959 to 2007. The main results showed that Iran's military and security expenditures significantly responded to a shock in oil revenues (or oil prices), while social spending components did not show significant reactions to such shocks.

Kablan, Loening and Tanaka (2014) examined whether Chad was affected by Dutch disease by first analyzing if Chad's economy presented some features that supported the existence of the natural resource curse, such as volatility in government resources, poor institutions, recurrent tensions, and mismanagement of oil resources. The results suggested that changes in domestic output and prices were determined by aggregate demand and supply shocks. However, findings showed that oil production and high international prices negatively affected agricultural output by small proportion. While associating the findings with structural underemployment and the inefficient use of existing production factor, the study concluded that increased public expenditures in tradable sectors present the opportunity to make oil revenues an engine of national development.

Cheng and Lai (1997) examined the causality between government expenditure and economic growth along with money supply in a trivariate framework over the period 1954 to 1994 in South Korea. In consistence with some of the previous studies that detected a feedback between GDP and expenditure, the study found bidirectional causality between government expenditures and economic growth in the country. Result of the study also suggested that money supply affected economic growth in South Korea.

Fölster and Henrekson (2001) examined the growth effects of government expenditure and taxation in a sample of rich countries over the period between 1970 and 1995. The general finding of the study was that the more econometric problems that were addressed, the more robust the relationship between government size and economic growth appeared. Gong and Zou (2002) set up a theoretical model linking the growth rate of the economy to the growth rate and volatility of different government expenditures. On the theoretical front, the study found that, depending on the inter-temporal elasticity in consumption, volatility in government spending can positively or negatively be associated with economic growth. Empirically, however, the study revealed a no-relationship between growth in capital expenditure and output growth, whereas growth in current expenditure seemed to drive output growth. Al-Bataineh (2012) investigated the impact of government expenditures on economic growth in Jordan during the period 1990 to 2010. Results from the study suggested that government expenditure at the aggregate level had positive impact on the growth of GDP in compatibility with the Keynesians theory. Also, the result showed that payment had no influence on GDP growth.

Contributing to the empirical literature on the debate about the validity of the Wagner's hypothesis, Salih (2012) tested the hypothesis in the context of Sudan for the period 1970-2010. The results clearly supported the Wagner hypothesis as the growth of per capita real GDP had

unidirectional relationship with the share of government spending to GDP. Thus, the study concluded that the Keynesian theory which states that an increase in government spending result in increases in GDP was not supported by the data from Sudan.

Alshahrani and Alsadiq (2014) empirically examined the effects of different types of government expenditures on economic growth in Saudi Arabia over the period from 1969 to 2010. Findings from the study indicated that while private domestic and public investments, as well as health care expenditure, stimulated growth in the long-run, openness to trade and spending in the housing sector could also boost short-run production.

Meanwhile, studies that had in different periods examined the nexus between governments spending and economic growth in Nigeria are vast in the empirical literature. For example, Oyinlola (1993) reported a positive impact of defense expenditure on economic growth. Also, Ogiogio (1995) revealed a long-term relationship between government expenditure and economic growth and also discovered that recurrent expenditure exerted more influence, than capital expenditure, on growth.

Furthermore, Fajingbesi and Odusola (1999) observed that real government capital expenditure had a significant positive effect on real output and that real government recurrent expenditure influenced growth only mildly in the country.

However, Akpan (2005) concluded that there was no significant relation between most components of government expenditure and economic growth in Nigeria. While employing a model that specified the effect of government consumption, investment spending, and private investment on real gross domestic product, Maku (2009) investigated the link between government spending and economic growth in Nigeria. The study found that private and public investments had insignificant effect on economic growth during the review period.

Ighodaro and Oriakhi (2010) found that increase in total government expenditure as well as specific expenditure on general administration and social services propelled economic growth. Adeniyi and Bashir (2011) found that government spending on agriculture, education, defense and internal security services as well as structural adjustment program was significant factor that influenced economic growth in the country.

Usman *et al* (2011) investigated the effect of federal government expenditure on economic growth in Nigeria. Results of the study showed that in the short run public spending had no impact on growth, but in the long run, a relationship was established between the two variables.

Oyinlola and Akinnibosun (2013) examined the relationship between public expenditure and economic growth in Nigeria during the period 1970-2009. After confirming the Wagner's law, the result of the study further showed that economic growth and development were the main objectives of government expenditure, especially investment in infrastructure andhuman resources all of which fall under social and community services.

Essentially, Nurudeen and Usman (2010) showed that total capital expenditure, total recurrent expenditure, and government expenditure on education had negative effect on economic growth. Government expenditure on transport and communication, and health, however, had positive impact on economic growth.

In corroboration, Adewara and Oloni (2012) explored the relationship between the composition of public expenditure and economic growth in Nigeria between 1960 and 2008. The study found that expenditure on education failed to enhance economic growth while expenditure on health and agriculture contributed positively to growth.

Also, in a related study, Kolawole, Omobitan and Yaqub (2015) found a significant positive association between government expenditure on health and per capita growth in Nigeria, as against significant negative impact of government expenditure on

education on per capita GDPover the period between 1980 and 2012 in the country.

Hamdi and Sbia (2013) empirically examined the dynamic relationships among oil revenues, government spending and economic growth in the Kingdom of Bahrain over the period from 1960 to 2010. The study investigated whether the huge government spending enhanced the pace of economic growth or not. Overall results suggested that oil revenues remained the principal source for growth, and the main channel which financed government spending.

It is imperative and noteworthy to examine whether oil revenue impact positively or not on economic growth and government expenditure. Using the Dutch disease theory which states that, the discovery of a natural resource (primary) has negative consequences which results from any large increase in foreign currency, including foreign direct investment, foreign aid or a substantial increase in natural resource prices.

The impediments of oil revenue to economic growth and development of oil-dependent states at the neglect of other sectors is what is cumulatively called Dutch Disease in the literature of development economics (Otawa, 2001). The enormous influx of cash resulting from oil tends to foster, overzealous and imprudent expenditure. High oil revenue raises exchange rates, promotes adverse balance of payment as the cost of imports rises. In fact, it kills incentive to risk investment in non-oil sectors, the competiveness of all non-oil sectors such as agriculture and manufacturing industries would be crowded out. If the employment of both labour and other resources has been exchanged for unemployment as the government and private expenditure multipliers have been exported abroad. Together, these forces constitute what Michael (2001) calls the rentier effect, oil states being rentier states.

3. Methodology

We use annual data on government oil revenue, public expenditure and real GDP from Nigeria for the period 1980-2016, sourced from the World Development Indicators of the World Bank (WDI, 2016), and employs Vector Error Correction Mechanism (VECM) since the examination considered both the short- and long-run impacts. Also, all the data series are transformed in natural logarithms so that their first differences approach the growth rates. From an economic point of view, this transformation also allows us to interpret coefficient estimates in terms of elasticity. Once the order of integration of each variable is determined and variables are found to be I(1), the concept of cointegration pioneered by Engle and Granger (1987) is used to examine the existence of cointegrating relationship among the variables. The concept of cointegration is intuitively appealing because it is supported by the notion of long-run equilibrium in economic theory. There exist several methods for testing for cointegration between two or more variables. In this study we conduct the Johansen cointegration test.

The Model

It is generally thought that revenue from crude oil has immediate impact on public expenditure as well as economic growth through the latter channel because production and sale of crude oil is on a monthly basis. The link between oil revenue, public expenditure and economic growth in Nigeria follows the conjecture of the model similar to that of Al-Qudair (2005) in the modified expressions in (1) and (2) below as follows.

$$InGexp_t = \delta_0 + \delta_1 Inore_t + \varepsilon_t \qquad 3.1$$

$$InGdp_t = \gamma_0 + \gamma_1 Inore_t + \gamma_2 InGexp_t + \mu_t \qquad 3.2$$

Where, t signifies time, δ_i and $\gamma_i$are coefficients, ε and μ are the respective error terms. Others are as earlier defined above. The a priori expectation is that a positive relationship would be established between growth and each of oil revenue and government spending.

4. Results and Discussion

Stationarity and Cointegration Result

We subjected the variables in the model to a stationarity test as part of the necessary diagnostic check and to ensure that our model is specified correctly.As a first step, the stationarity of the variables was tested by conducting the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests. The results, as presented in Table 4.1 showed strong evidence(s) that all the variables were integrated of order one, that is, I(1). The next step was to test for the presence of long-run relation among the variables, that is, cointegrating relationships. Table 4.2 and Table 4.3 shows the results of the cointegration tests which suggested three, and at least one cointegration equation at the 5 percent level of significance.

Table: 4.1 Augmented Dickey-Fuller and Phillips-Perron Unit Root Test

Variable	Stage	Critical Value	1%	5%	10%
LnGdp	1st Difference	-5.964880	-2.664853	-1.955681	-1.608793
LnOrev	1st Difference	-9.356430	-3.724070	-2.986225	-2.632604
LnGsp	1st Difference	-8.113853	-2.647120	-1.952910	-1.610011

Table: 4.2 Result of the Johansen Cointegration Rank Test (Trace)

Hyp. No.	Eigenvalue	Trace Stat	5% C.V	Prob.
r = 0	0.500719	44.15919	29.79707	0.0006
r ≤ 1	0.367707	22.62704	15.49471	0.0036
r ≤ 2	0.237766	8.416555	3.841466	0.0037

Source: Authors 'computation from Eviews version 8.1

Table: 4 3. Result of the Johansen Cointegration Rank Test (Maximum Eigenvalue)

Hyp. No.	Eigenvalue	Max-Eigen Stat	5% C.V	Prob.
r = 0	0.500719	21.53215	21.13162	0.0439
r ≤ 1	0.367707	14.21048	14.26460	0.0510
r ≤ 2	0.237766	8.416555	3.841466	0.0037

Source: Authors' computation from Eviews version 8.1

Granger Causality and ECM Results

As presented in Table 4.4, the causality relationship between growth and government was bidirectional as both variables Granger caused each other. Oil revenue, however, had a unidirectional relationship with each of growth and government spending. Specifically, the results revealed that oil revenue Granger caused growth at 5 per cent level of significance as against Granger causing government spending at 1 per cent level of significance. Since Granger test is sensitive to the number of lags of the explanatory variables included in the causality equations, the Information Criterion (AIC) (Akaike, 1969), amongst others, was used to choose the optimal lags as presented in Table 4.5.

Table: 4.4 Pairwise Granger Causality Test Result

Null Hypothesis	Obs	F-statistic	Probability	Decision
Orev does not Granger cause Gdp	36	5.30894	0.0117	Reject
Gdp does not Granger cause Orev	36	0.57336	0.5706	Accept
Gsp does not Granger cause Gdp	36	1.01595	0.3760	Accept
Gdp does not Granger cause Gexp	36	0.37681	0.6897	Accept
Gsp does not Granger cause Orev	36	0.89043	0.4226	Accept
Orev does not Granger cause Gexp	36	6.85288	0.0041	Reject

Source: Authors' computation from Eviews version 8.1

Table: 4.5 Lag Length Selection Criteria

Endogenous variables: LNOREV LNGSP						
Lag	LogL	LR	FPE	AIC	SC	HQ
0	-1021.66	NA	1.70E+15	74.34657	71.34657	71.13608*
1	-1080.15	62.65413*	1.21e+15*	73.79976	72.67045	71.32632
2	-1053.77	29.90087	3.41E+25	74.34989*	78.08366*	72.20246

Source: Authors' computation from Eviews version 8.1

The estimated coefficient of the error correction term, ECT(-1) which is also the speed of adjustment to equilibrium, was negative and statistically significant as required by the granger representation theorem. This, as shown in Table 4.5, implied the validity of the long run relationship between each pair of the variables. The speed of adjustment to equilibrium required 83 per cent within a year when the variables drifted away from their equilibrium values. Thus, it provided enough evidence that GDP and Gexp; Gdp and Orev; as well as Orev and Gexp were cointegrated over the period considered. In addition, the ECM result revealed that oil revenue and government spending drove economic growth positively at 5 per cent and 10 per cent level of significance, respectively. This implied that a hundred percentage point increase in oil revenue, as well as in government spending caused a rise in growth of about 38 per cent and 3 per cent, respectively.

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Table: 4.6 Error correction model (ECM)

Variable	Coefficient	Std. Error	t. Statistic	Prob.
D(LNORV)	0.38669	0.089668	2.08676	0.0231
D(LNTXP)	0.03215	0.072754	1.95755	0.0779
ECT(-1)	-0.83224	0.192676	-3.37518	0.0036
Adj. R2: 0.501142	DW: 1.773328			

Source: Authors' computation from Eviews version 8.1

5. Conclusion

This study has examined the relationships among oil revenue, government spending, and economic growth in Nigeria. Specifically, it investigated if oil revenue impacted on government spending, as well as on economic growth in the country over the period 1980 to 2016. Econometric techniques which included VECM, cointegration and Granger causality were employed to determine the direction of causality and the magnitude of impacts. Findings from the analysis revealed that oil revenue granger caused total government spending, while there was no causality between government spending and growth. Also, it was revealed that oil revenue granger caused as well as impacted positively on economic growth. It was therefore concluded that oil revenue has been a very important

variable that propelled government spending and economic growth in Nigeria.

6. Recommendations

The foregoing findings bear some implications for policy formulation. Firstly, given no-causality between government spending and growth, even though a mild impact of the former on the latter was reported, the government needs to re-examine the shares of both capital and recurrent expenditure in total government spending. Over the years, the percentage of recurrent expenditure has over-blotted to the extent that more than 70 per cent of the country's budget was allocated to this item at the expense of capital spending. A situation of such can only bring about a mild nominal non-inclusive growth which has been the experience over the years.

Therefore, government should boost spending on capital or developmental projects. By doing this, jobs would be created, the economy would grow and poverty would decline. Secondly, because government spending and economic growth were granger caused and largely influenced by revenue from oil, it follows therefore that government should intensify efforts at increasing output in the oil sub-sector. In doing so, revenue would improve and more funds would be available for spending, and growth. It must; however be burn in mind that while trying to boost production of oil, government must not over-concentrate on the oil sub-sector by shifting interest from the non-oil sector in the country.

This is important because of the fact that experience has shown that natural oil reserve level could deplete to zero. A situation of zero oil reserve implies a zero production as well as zero revenue from oil. Therefore, assuming Nigeria finds itself in this condition, what then happens to government spending, employment, poverty, and growth? The bestway out of this imminent threat is that as efforts at boosting oil production and revenue are being intensified, the government should also devote significant resources to developing the non-oil sector. Substantial resources should be made available to the agriculture sector where cash crops produce like rubber, cocoa, palm oil and kernel, ground nut, cola nuts, and so forth could be largely produced for export, and local consumption.

Again, the manufacturing sub-sector should be provided with resources like electricity, road infrastructure, long- and medium-term credit facilities, and enabling business environment in order to boost production for export, and possibly help in the manufacture of some goods that are presently imported. If the government does this it would broaden the revenue base, and assist in stabilizing the economy in the period when revenue from oil drops as a result of resource depletion or decline in the international price of oil as currently being experienced.

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