

Fiscal Policy, Institutional Quality and Inclusive Growth in Nigeria.

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Abstract: This study set out to investigate the impact of fiscal policy and institutional quality on inclusive growth in Nigeria from 1985-2017. This was achieved through the use of two models, with the human development index (HDI) and per capita Gross Domestic Product (PGDP) being the main dependent variables used to capture the degree of inclusiveness of growth in Nigeria. These equations were estimated using the ordinary least squares method of estimation. The study found that fiscal policy has a significant effect on inclusive growth in Nigeria while quality of domestic institutions was found to have an insignificant impact on inclusive growth in Nigeria. Based on the findings, the study recommended that government should not neglect fiscal policy as it is invaluable for a more inclusive growth; increase recurrent expenditure on economic services, transfers and capital expenditure, and public spending on the provision of social and community services should be effectively monitored to avoid misappropriation of funds. Also recommended was the fight against corruption to strengthen institutional quality in Nigeria.

Key word:Institutional Quality, Fiscal policy, Inclusive Growth.

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I. INTRODUCTION

The last decades of the twentieth century was characterized by the increase in the emphasis on the attainment of rapid and sustained levels of economic growth, especially among developing nations. This emphasis was anchored on the belief that growth would automatically lead to increased levels of employment, and thus improvement in the general welfare. However, the certainty of this has been debunked by development theorists who have argued that sustained rates of growth do not automatically translate to improvement in the welfare of the average individual in a society. This is because rapid rates of growth might be due to the actions of a minority of the economic agents in an economy, meaning that the distribution of the gains from growth is restricted to this small segment of the population. For instance Ali and Son (2007) observed that growth can bypass the poor or marginalized groups, resulting in increasing inequality. This has resulted in the recent clamour for the need for growth to be inclusive.

In Nigeria, the recent rebasing of the Gross Domestic Product (GDP) in 2013 resulted in the country's economy being ranked as the largest in Africa and one of the fastest growing in the world (Chima, 2014). However, observers have become increasingly concerned that this growth has been too even and often accompanied by rising income inequality. In addition, it has been observed that the disadvantaged groups such as members of ethnic minorities, people in remote rural areas and women have not benefited proportionately from the rapid economic growth (Klasen, 2010). In recognition of this, there have been renewed attempt to ensure the even distribution of the gains of growth in the country by ensuring that it is more inclusive. This is evidenced in the 2013 budget speech titled "Fiscal consolidation with inclusive Growth" (Vanguard News, 2012). Fiscal policy is one of the most effective tools that can be used for redistribution for the attainment of inclusive growth alongside institutional quality. This may involve the increases or decrease in the level of taxes, the taxes on specific activities or commodities, and overall increases or decreases in government spending. The former case occurs when government spends more than it earns (Weil, 2008).

However, the ability of the Nigerian government to ensure the inclusiveness of economic growth in the country is dependent on the soundness of its policy, especially with respect to its income and expenditure and the quality of domestic institutions. Fiscal policy refers to the use of government spending and taxation to influence the economy (Weil, 2008). Fiscal policy is usually used for different purposes. This includes the stimulation of economic activity via increase in the level of consumption, investment, output and income. Fiscal policy may also be used as an instrument for the promotion of the equitable distribution of income in the society. This generally occurs where the tax system is progressive. On the other hand, institutional quality refers

to the ability of a countries domestic, legal, political, financial and social institutions to ensure the attainment of certain outcomes which according to Levchenko (2004) include the enforcement of contracts, property rights, shareholder protection etc. In highlighting the importance of institutions, Budak (2006) observed that it would be impossible for a society to ensure the enforcement of contracts, protection of property rights, business contracts, ensure the adequate and timely discrimination of information to economic agents, and ensure transparency and accountability in an environment characterized by weak institutions. It was opined that in such a situation, the cost and risk of doing business would be very high, thus resulting in reduced propensity to invest. Also, another importance of institutional quality lies in its role in ensuring that all citizens have equal access to opportunities for investment and self-improvement on one hand, and access to the gains from the growth process. This study is carried out to assess the impact of the aforementioned variables on the inclusiveness of economic growth in the Nigeria.

STUDIES ON FISCAL POLICY AND ECONOMIC GROWTH

Adeoye (2011) analyzed the impact of fiscal policy on economic growth in Nigeria from 1970 to 2002. The findings showed that public investment negatively affects output growth, implying that public expenditure has a crowding out effect on private investment.

Modebe, Okafor, Onwumere and Ibe (2012) examined the effect of recurrent and capital expenditure on Nigeria's economic growth, while capital expenditure had negative and non-significant impact on economic growth. The results of a related study by Nurudeen and Usman (2010) revealed that government total capital expenditure, total recurrent expenditures and government expenditure on education had negative effects on economic growth. On the other hand, rising government expenditure on transport, communication and health resulted in an increase in economic growth.

Ubi and Udah (2014) examined how corruption and institutional quality have impacted on economic performance in Nigeria. The study revealed that corruption and institutional quality had a statistically significant effect on economic performance in the country. Among others, the study recommended that education for the masses was necessary for improved economic performance in Nigeria. In conclusion, it pointed out that if corruption was successfully fought, institutions would be strengthened and inclusive growth would result.

Ifere, Okoi and Bassey (2015) investigated the relationship between institutional quality, macroeconomic policy and economic development in Nigeria using four development indicators; the prevalence of under nourishment, life expectancy at birth, the human development index (HDI) and gross domestic product (GDP) per capita from 1995-2013 to examine the validity of the proposed framework. The result indicated that institutional quality did not have a significant impact on the development indices used in the study. On the other hand, government expenditure was found to exert a significant, though small impact on the country's development indices. The study recommended a holistic approach to attitudinal change, systematic strengthening and development of institutions to enable the country achieve its development objectives.

A study by Okoh and Ebi (2013) examined the effect of interaction of infrastructure investment and institutional quality (corruption and contract enforcement) on economic growth in Nigeria, using correlation matrix and granger causality test. The study found that infrastructure has a robust positive influence on economic growth. Corruption has a negative and significant effect while contract enforcement has positive and significant effect on quality on economic growth. Interaction between infrastructure investment and institutional quality on economic growth were insignificant. It appeared that low levels of contract enforceability and increase in corruption render the positive infrastructure investment – economic growth nexus insignificant in Nigeria.

Empirical studies on fiscal policy and inclusive growth in Nigeria

The concept of inclusive growth and its determinants is relatively new and of interest among economists. As such, few empirical literatures exist on the issue. In general, one of the challenges encountered by researchers in their attempt to study the concept has to do with choice of variables and measures to capture the concept of inclusive growth. However, the recent Nigerian economic society annual conference yielded encouraging empirical evidence. For instance, Asogwa (2015), in examining the impact of fiscal policy on inclusive growth in Nigeria used three approaches. First, a decomposition of public expenditures in Nigeria was conducted so as to evaluate the relative allocation to inequality reducing sectors (education, health, social transfers/services) with other sectors over a period of time. Second, the benefit incidence of the expenditures on education for all the income quintiles was analyzed. Third, the study measured the incidence of the different tax revenue components in Nigeria to ascertain whether they are progressive or regressive and its redistributive impact. The findings of the study showed that the current structure of public expenditure and taxes are not progressive enough and have limited powers to reduce inequality and enhance inclusive growth.

Shobande (2015) carried out a study to determine the impulse response of fiscal policy to fiscal space in the quest for inclusive growth between 1981 and 2014, using Structural Vector Autoregressive (SVAR) model and Error Correction Mechanism (ECM). The interaction among all variables considered for the analysis

included in the VAR such as per capita income, unemployment, government expenditure, external debt and debt servicing. The findings on per capita income revealed an incremental positive value for all the periods due to shocks in government expenditure, whereas response of unemployment rate is positive in the first two periods and later reacts negatively in the latter periods to the same shock. It was concluded that this is an indication that fiscal space indicator, external debt and government expenditure are the main shocks responsible for the variation in inclusive growth in Nigeria. The paper recommended that appropriate policies towards boosting the mobilization of additional resource to accommodate fiscal space while keeping debt limits to avoid fiscal shock in the country be formulated.

Another study by Yaru, Mobolaji, Kilishi and Yakubu (2015), evaluated the inclusiveness of Nigeria's economic growth, while at the same time, examining the impact of public expenditure on inclusive growth in Nigeria. The study used secondary data for the period 1960 to 2012. Principal component analysis and regression analysis were used to analyze the data. The results showed that only the impact of state governments' expenditure was significant at 10 percent. It was however found that expansionary fiscal policy could undermine inclusive growth if it leads to inflation. The result suggested that excessive trade openness could inhibit the inclusiveness of the growth process. The study therefore recommended that public expenditure does not have strong influence on inclusive growth in Nigeria.

A similar study by Yaru, Mobolaji, Kilishi and Yakubu (2011), looked at impact of public expenditure in Nigeria on one of the fundamental elements of inclusive growth i.e., reduction in unemployment rate. The study found that composition of public expenditure did not matter in solving the lingering unemployment problem; instead increasing the share of the manufacturing output in Nigeria's GDP is more potent.

Arodoye and Adegboye (2015) examined the impact of the tax structure and tax base on inclusive growth in Nigeria from 1981 to 2013. The results of the study indicated that company income taxes performs best in explaining changes in government spending while VAT performed worst. The results also revealed that spending patterns that are economic and productive tend to provide optimality for taxation in terms of productivity growth. In relation to tax structure, the study found that indirect taxes are more output stimulating than direct taxes. Therefore, growing the economy in terms of productivity and employment generation requires more appropriate titling of the tax structure towards indirect taxation as well as channeling tax revenues to more productive uses.

Another study by Samuel (2015) investigated the impact of the tax revenue from tax cut on inclusive growth in Nigeria. The study used a set of structural and reduced form of equations based on the VAR model. Several tests were conducted such as unit root test, cointegration test, JaqueBera test for normality, Breusch-Godfrey serial correlation LM test, Breusch-pagan-Godfrey test for heteroskedasticity, granger causality test, and impulse response analysis. The results showed that there is a very high long run relationship between tax revenue and growth. It was found that a reduction in taxes (both on corporate and personal incomes) would have a spiral effect on employment generation which will in turn boost growth and reduce inequality and poverty thereby promoting inclusive growth.

Adeola (2015) explored the relationship between fiscal policy, inclusive growth and social welfare using Rosenstein-Rodan's thesis of Big-push theory. Analysis revealed that changes in government spending and tax rates achieved a potentially substantial reduction in government debt at least cost to social welfare. The results of the study showed that the implementation of fiscal policy may affect growth, social inclusion and income distribution which ultimately shapes the social welfare on which impact is based.

Kolawole (2015) examined the relationship among public spending, institutional quality and inclusive growth in Nigeria over the period 1995-2013. The study used the Dickey-filler GLS unit root test to ascertain the order of integration of the series. Also, due to the small sample size of the data, it employed the ARDL bound testing technique to determine the long-run relationship among the variables. Furthermore, it adopted the vector error correction mechanism to find the short-run relationship among the series. Consequently, the study found that in the long run public spending on health; economic freedom and real GDP growth rate significantly influenced inclusive growth positively in Nigeria. Thus, it was concluded that public spending in the form of redistributive public spending on health, institutional quality as economic freedom and real GDP growth rate propelled inclusive growth in Nigeria. It was therefore recommended that government should direct its policy strategies on increasing productive public spending on health, education and infrastructure. Also, the government should formulate and implement institutional strengthening policies in areas of labour freedom, investment freedom, property rights and other life enhancing programmes that can specifically help reduce inequality and poverty in the country.

Richard (2015) examined optimal fiscal policy and inclusive growth using Dynamic Stochastic General Equilibrium (DSGE) model over the period 1986 to 2013. The study found that there is no scope for growth inclusiveness given the prevailing economic structure in Nigeria, as poor households are subject to low and widely variable welfare which makes it impossible for them to take advantage of growth opportunities.

Adenaike (2015) examined fiscal policy and inclusive growth in Nigeria as an empirical analysis of the interaction of fiscal monetary policy trade off over the period of 1970 to 2014. The Augmented Dickey fuller unit root test were employed and error correction mechanism to reconcile the short run behaviour of the economic variables with its long run behaviour. The results suggest a positive long run co-movement between the levels of government expenditure, money supply and growth rate on one hand, while revenue, money supply and growth rate on the other, with the revenue changes inducing permanent changes in long run expenditures. The long run model showed that fiscal and monetary policy measures impact positively on economic growth. The paper therefore recommended that appropriate channeling of the nation's capital expenditure on education and health to promote inclusive growth together with appropriate policies coordination.

Summary of literature and knowledge gap

Several literatures were reviewed on the impact of fiscal policy and institutions on inclusive growth in this study. Other literature reviewed in this study relate to the impact of fiscal policy and institutions on economic growth. The latter was carried out to provide a context within which the findings of the study and their relevance of policy purposes may be situated.

From the review it can be seen that while studies such as Asogwa (2015), Arodoye and Adeboye (2015), Yaru et al (2015), Adeola (2015) and Kolawole (2015) have extensively examined the impact of fiscal policy and institutions on inclusive growth in Nigeria, their main weakness has been with respect to the choice of measure of inclusive growth. For instance Kolawole(2015) used GDP as a measure of inclusive growth, eroding the reliability of the results of the study. This is because GDP is and has historically been used as a measure of economic growth. It does not give an indication on the distribution of such income among the citizens of a country.

In this study, two main measures are used to capture inclusive growth, per capita GDP and human development index. This study also differs from other studies because in evaluating the impact of fiscal policy and institutions on inclusive growth in Nigeria, the study divides government expenditure into its different components. In this way, the impact of the individual elements of government recurrent and capital expenditure on inclusive growth will be highlighted.

II. METHODOLOGY

This study used data covering from 1985-2017 mainly from secondary sources. The design used in the conduct of this study is the ex-factodesign. The choice of this design is predicted on the historical nature of the analysis carried out in the study. In doing this, data on the relevant variables was derived from the relevant statistical bodies and subjected for analysis from which conclusions on the relationship being examined was made based on the estimation of two variables which was used to capture the impact of fiscal policy and institutional quality on inclusive growth in Nigeria.

Inclusive growth is captured in this study using variables such as per capita gross domestic product and human development index. The theoretical underpinning of this study is eclectic. As such, the following models are anchored on the Keynesian and the endogenous growth theories. The models are specified as follows:

$$\begin{aligned} \text{PGDP} &= F(\text{GXS}, \text{GXE}, \text{GXT}, \text{GCE}, \text{EFI}) \dots\dots\dots 1a \\ \text{HDI} &= F(\text{GXS}, \text{GXE}, \text{GXT}, \text{GCE}, \text{EFI}) \dots\dots\dots 2a \end{aligned}$$

Where:

- PGDP = Per capita gross domestic product
- HDI = Human development index
- GXS = Government recurrent expenditure on the provision of social and community services
- GXE = Government recurrent expenditure on the provision of economic services
- GXT = Government recurrent expenditure on transfer
- GCE = Government capital expenditure
- EFI = Index of economic freedom

The models for the study are expressed econometrically as follows:

$$\begin{aligned} \text{PGDP} &= \alpha_0 + \alpha_1 \text{GXS} + \alpha_2 \text{GXE} + \alpha_3 \text{GXT} + \alpha_4 \text{GCE} + \alpha_5 \text{EFI} + U_1 \dots\dots 1b \\ \text{HDI} &= \beta_0 + \beta_1 \text{GXS} + \beta_2 \text{GXE} + \beta_3 \text{GXT} + \beta_4 \text{GCE} + \beta_5 \text{EFI} + U_2 \dots\dots 2b \\ \alpha_0, \beta_0 &> 0; \alpha_1, \beta_1 > 0; \alpha_2, \beta_2 > 0; \alpha_3, \beta_3 > 0; \alpha_4, \beta_4 > 0; \alpha_5, \beta_5 > 0 \end{aligned}$$

Where: α_0 and β_0 = constant term

α_1 - α_5 and β_1 - β_5 = parameter estimate of the coefficients in model 1 and 2

U_1 and U_2 = stochastic or random error term (with usual properties of zero mean and non-serial correlation)

The models for the study are estimated using ordinary least squares (OLS) method of estimation, based on its characteristics of being the "best linear and unbiased estimator" (BLUE) among the estimates of the parameters of economic relationship.

III. RESULT AND DISCUSSION OF FINDINGS

From the result obtained, government recurrent expenditure on economic services was found to be positive and significant in relation to per-capita GDP while it was found to be positive but insignificant in relation to human development index. Thus government recurrent expenditure on economic services is invaluable as it contributes to the growth of per-capita GDP. The first contradict the study of Modebe et al (2012) which found recurrent government expenditure to have positive and non-significant impact on growth. But the latter support the study of Modebe et al (2012).

Government recurrent expenditure on the provision of social and community services was found to be positive but insignificant with respect to per-capita GDP while it was found to be negative and insignificant in relation to human development index. This indicates low level of human resource development and lower productivity. As asserted by Asogwa (2015), this expenditure has a great potential for reducing income inequality as it includes expenditure on health, education and other social and community services. In relation to per-capita GDP the study supports Modebe et al (2012) which found recurrent government expenditure to have a positive and non-significant impact on growth while in relation to human development index the study supports Nurudeen& Usman (2010) whose study found that total recurrent expenditure had negative effects on economic growth.

Government recurrent expenditure on transfer was found positive and significant both in relation to per-capita GDP and human development index. This means that recurrent expenditure on transfer contributes greatly to human development and per-capita GDP in the country. As stated by Asogwa (2015), there is evidence that increased governmental transfer help reduce criminal activities, thereby alleviating social tensions and instability. This is in contrast to the findings of Modebe et al (2012) which found government recurrent expenditure to have positive and non-significant impact on economic growth.

Government capital expenditure was found positive and significant in relation to per-capita GDP and human development index in Nigeria. This contradict the findings of Modebe et al (2012) and Nurudeen& Usman (2010), which found capital expenditure to have a negative and non-significant impact on economic growth. Thus, there is need for government to increase capital expenditure to create an enabling business environment for investment promotion in the country.

With respect to the measure of institutional quality, index of economic freedom, it was found to be negative and insignificant in relation to per-capita GDP while it was found positive and insignificant in relation to human development index. This supports the findings of Ifere, Okoi and Bassey (2015), which indicated that institutional quality did not have a significant impact on the development indices. This as well supports the findings of Okoh&Ebi (2013) which found institutional quality on economic growth to be insignificant. The study contradicts the findings of Ubi&Udah (2014) of which institutional quality was found to have a significant effect on economic performance and Kolawole (2015) which found economic freedom to have a positive and significant influence on inclusive growth in Nigeria.

In summary, public expenditure have influence the growth performance of the economy more in terms of human development index than per capita GDP. This is in line with findings of Kolawole (2015) which concluded that public spending in form of redistributive public spending significantly influenced inclusive growth positively in Nigeria. Also in support is the findings of Adeola (2015), showed that the implementation of fiscal policy may affect growth, social inclusion and income distribution. The study contrast the findings of Yaru et al (2015) which concluded that public expenditure does not have strong influence on inclusive growth in Nigeria. Also in contrast is the study of Asogwa (2015) which found the current structure of public expenditure to have limited powers in reducing inequality and enhancing inclusive growth. On the other hand, institutional quality does not have significant effect on growth performance of the Nigerian economy both in terms of human development index and per-capita GDP.

IV. CONCLUSION AND RECOMMENDATION

The concept of inclusive growth evolved due to sustained economic growth experience of some developing economies over the past one decade, which was characterized by the paradox of growth without development (Folawewo&Adedekun, 2015). Findings shows government expenditure has a significant effect on inclusive growth in Nigeria, both in relation to per-capita GDP and human development index. The measure of institutional quality, index of economic freedom does not have a significant impact on the growth performance of the Nigerian economy both with respect to per-capita GDP and human development index. Thus, fiscal policy is invaluable to the growth performance of the Nigerian economy and should not be neglected by the government. Also, policies should be taken to strengthen institutional quality in the country.

Table 1Regression result for equation one (per capita GDP)

Variable	Coefficient	Std. Error	t-statistic
C	3.445063	0.229460	15.01375
GXE	0.001594	0.000349	4.571781
GXS	0.000291	0.000384	0.757171
GXT	0.000886	0.000289	3.062126
GCE	0.000270	9.05E-05	2.981416
EFI	-0.022472	0.058019	-0.387316
R-squared		0.960055	
Adjusted R-squared		0.951733	
F-statistic		115.3643	
Durbin-Watson Stat		1.318985	

Critical values: t-statistic (5%); 2.064; F-statistic (5%); 2.62

Source: Author's computation, 2019

Table 2Regression result for equation two (Human Development Index)

Variable	Coefficient	Std. Error	t-statistic
C	0.344101	0.024019	14.32627
GXE	3.39E-05	3.65E-05	0.927715
GXS	-3.10E-05	4.02E-05	-0.771562
GXT	6.31E-05	3.03E-05	2.083868
GCE	2.44E-05	9.48E-06	2.573848
EFI	0.008146	0.006073	1.341337
R-squared		0.875894	
Adjusted R-squared		0.850038	
F-statistic		33.87648	
Durbin-Watson Stat		0.410552	

Critical values: t-statistic (5%); 2.064; F-statistic (5%); 2.62

Source: Author's computation, 2019

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