# Fiscal Policy and Economic Growth in Nigeria: A Comparative Analysis with Emerging and Industrialized Economies

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## Abstract

This study examines the impact of fiscal policy on economic growth in Nigeria, from the military to the current civilian administration. The study demonstrates the effectiveness of fiscal policy in supporting economic growth, particularly in low-income countries with macroeconomic disparities, by a comparative comparison of developing and industrialized economies. Keynesian economic theory was used in the investigation. Many people consider the British economist John Maynard Keynes (1883–1946) to be among the most significant thinkers of the 20th century. The study utilized documentary research methodology and qualitative analysis, the study reveals that fiscal adjustment is a crucial driver of growth, primarily through its impact on factor productivity. Furthermore, the findings show that improving public investment and safeguarding capital expenditure during fiscal adjustment are essential for encouraging economic growth. Conversely, shifts in spending priorities that favor public-sector wages and salaries can potentially stifle growth due to their association with rent-seeking behavior. Based on these findings, the study recommends that policymakers should prioritize efficient distribution and utilization of public resources, to strengthen the Nigeria Central Bank's capacity to address economic challenges, and incorporate seasoned administrators and economists into the nation's economic recovery team. By implementing these measures, Nigeria can adequately promote inclusive and sustainable economic growth, ultimately enhancing the well-being of its citizens.

## Keywords

Public Financial Management, Fiscal Policy, Economic Growth, Nigeria, Emerging Economies, Industrialized Economies

## 1. Introduction

Public Financial Management (PFM) is a crucial aspect of governance that deals with a government's revenue and expenditure. It involves budgeting, revenue generation, and spending, which are essential for economic stability and reflecting government priorities. Effective fiscal management promotes transparency, accountability, and trust in government, encouraging citizen participation in the democratic process. Understanding PFM is vital for grasping the concept of fiscal policy and its impact on economic growth, particularly in the Nigerian context. Public financial management involves the control and administration of public revenue and financial resources. It requires prudent management of liquidity and financial assets to meet community needs while maintaining transparency and accountability [1]. As highlighted in Nigeria's constitution, effective public financial management ensures efficient resource allocation, even in unforeseen circumstances, through mechanisms like the Contingencies Fund.

More significantly, public financial management refers to the rules, policies, practices, and tactics that governments employ to manage public funds, including the creation of revenue, its distribution, expenditure, accounting, and auditing, in order to maintain accountability and transparency. In Nigeria, the Federation Accounts Allocation Committee (FAAC) is in charge of making sure that allotments from the Federation Account to the states are paid into each state's treasury on time and in full. In accordance with the law, the FAAC also makes sure that funds given to local government councils are dispersed. It involves a more extensive array of activities beyond the management of finances and is typically thought of as consisting of a six-phase pattern that begins with the formulation of policies and culminates with independent auditing, evaluation and the development of government functioning Ministries, Departments And Agencies (MDAs).

Governments utilize a set of rules, laws, and practices known as Public Financial Management (PFM) to manage public funds. Bookkeeping, external auditing, budget creation, approval, implementation, and policy building are the six stages of the PFM cycle. While preserving accountability and openness in governance, PFM seeks to guarantee operational effectiveness, strategic resource allocation, and fiscal restraint [2].

**Figure 1.** Six Stages of the PFM Cycle

### 1.1 Brief Overview of Fiscal Policy

Fiscal policy can drive economic and social progress through various channels, including macroeconomic variables (e.g., budget deficits' impact on GDP) and microeconomic factors (e.g., impact on resource efficiency). The concept of fiscal policy has evolved over time, transforming from a flexible and broad definition to a more focused concept of macroeconomic stabilization through taxation and government expenditure, particularly after the 1930s. Effective fiscal policy in emerging nations involves moderate fiscal deficits and government debt, which can drive economic growth, reduce economic hardship, and improve quality of life. Modest budget deficits can also mitigate the risk of economic crises by keeping debt repayment costs manageable, allowing for essential funding of social programs and preventing unsustainable debt accumulation. A stable economic environment fosters favorable conditions, including increased investment, development, and academic achievement [3]. Fiscal policy can play a crucial role in minimizing economic volatility and stimulating economic activity. However, the effectiveness of fiscal policy can be hindered by high and unsustainable levels of government debt, which can limit its potential to boost consumption and production.

Though research indicates that reducing budget deficits or spending gaps can boost growth in countries with excessive public debt by lowering borrowing costs, increasing private sector investment, and enhancing asset values, which can then lead to increased spending and investment, ultimately alleviating supply constraints on growth, it is unclear whether this process applies to resource-limited countries like Nigeria. Broad-based appropriations may not be appropriate for governments expecting significant foreign support because of the potential negative macroeconomic impacts from increased funding flows and inefficient integration.

### 1.2 Types of Fiscal Policy

There are two main types of fiscal policy. They are:

- **Neutral Fiscal Policy**

It is immediately apparent that fiscal policy can be regarded as balanced when the amount of money spent by the government in relation to tax revenue stays constant throughout time. This type of approach is usually used in economies that are in balance, meaning they are neither rapidly growing nor rapidly contracting. The government's spending is fully funded by tax revenue in each of these scenarios, thus it has no impact on economic expansion.

- **Discretionary Fiscal Policy**

Fiscal policy adopted by governments that changes government spending or taxation is referred to as discretionary fiscal policy. Its goal is to foster growth or contract the economy as required. It is divided into two types:

**(i) Expansionary Fiscal Policy:** If the federal government allocates greater amounts of cash than it collects in taxes, it is considered to have Expansionary fiscal policy. The aforementioned kind of fiscal policy is typically implemented in economic downturns to stimulate GDP growth.

**(ii) Contractionary Fiscal Policy:** Contractionary fiscal policy is defined as government spending being less than tax receipts. This fiscal policy is implemented to reduce the debt of the government and to control price increases otherwise regarded as hyperinflation.

### 1.3 Role of Fiscal Policy in Emerging Economy

The main goal of fiscal policy in any freshly growing country is to encourage the fastest possible rate of economic capital accumulation. In developing or underdeveloped nations, fiscal policy should seem to encourage rapid economic expansion. It is no longer possible to think of fiscal policy in a developing economy as compensating. It has a challenging role to play in developing countries that have to resolve the growth-cum-stability dilemma without sacrificing either. In developing economies, fiscal policy serves the following purposes:

#### 1.3.1 Resource Mobilization

Developing countries have a very high marginal propensity for consumption due to their acute poverty and low earnings. As a result, these economies have relatively low levels of saving. Therefore, fiscal policy which includes government loans and taxes is essential to creating savings for capital investments. By providing various tax advantages and subsidies, it may also have an effect on the creation and accumulation of money in the private sector.

#### 1.3.2 Development of Private Sector

In an economy that is emerging, private enterprise is a critical component of the economy. Fiscal policy can have an impact on private sector output as well as efficiency. To stimulate valuable turnover in the private sector, incentives such as tax discounts, and subsidies may be offered. To secure appropriate resources for the private sector, fiscal tools and initiatives can be employed to stimulate the marketplace for capital.

#### 1.3.3 Optimization of Resources Allocation

In emerging economies, fiscal strategies can be used to distribute resources as efficiently as feasible. Private sector funding is often directed towards the production of goods that cater to the demands of the affluent parts of society. Fiscal strategies work well for directing generated funds into profitable investment avenues. As a result, various financing programs and tax breaks can be employed to support the reallocation strategy.

#### 1.3.4 Creation of Social and Economic Overheads

The effective development of basic infrastructures, which are essential for economic advancement, is lacking in emerging economies. People's capacity for productivity will rise instantly when social overheads like healthcare and educational possibilities are made available. The industrialization process will be accelerated by spending on economic overheads like telecommunications, power generation, and transportation. Therefore, by fiscal measures like taxation and spending programs, the government must engage in the building of social and economic administrative costs.

#### 1.3.5 Balanced Regional Development

Regional imbalance is a problem for developing economies in terms of economic development. Fiscal tools like tax breaks, tax holidays, subsidies, asset utilization incentives, and so forth can be made available to private sector investors as part of balanced growth strategies to attract private investment to these underdeveloped regions of the world.

#### 1.3.6 Economic Stability

To successfully control seasonal variations that arise within the phases of economic growth, fiscal policies including taxation and expenditure plans may be put into place. One effective way to combat hyperinflation and depressed conditions is through taxation.

#### 1.3.7 Reduction of Inequality

Equal opportunity in terms of wealth, employment opportunities, and financial status is crucial for economic progress in emerging nations. There is a chance that fiscal policy will greatly lessen wage inequality. Redistribution of income requires the use of taxation systems. The following fiscal measures are intended to decrease income, wealth, and potential income disparities: changes in financial and real estate taxes, high taxes on high-priced goods, tax exemptions or leniencies for general-consumption goods, and reductions in government spending.

### 1.4 Fiscal Policy Objectives

The goal of fiscal policy is to guarantee full-time employment, a healthy economy, and growth rates that are stable. The following are the overarching objectives of fiscal policy:

#### 1.4.1 Full Employment

The first and most important goal of fiscal policy in an emerging economy is to attain and sustain full employment. Even when full-time employment is not realized within these countries, the essential goal is to steer clear of unemployment and achieve near-full employment. As a result, in order to eliminate underemployment and joblessness, the government should spend enough on both economic and social administrative expenses. These spending decisions are projected to develop additional job opportunities and boost the economy's productive efficiency.

#### 1.4.2 Price Stability

Price changes affect several facets of society, such as farmers, producers, traders, and consumers as well as total workers and those employees. The general public is negatively impacted by price hikes. By lessening the adverse consequences of price increases and falls, fiscal policy aims to stabilize prices. Reducing taxes or offering subsidies are two ways to offset price increases.

#### 1.4.3 Accelerating the Rate of Economic Development

The primary goal of fiscal policy in emerging-economy nations must be to accelerate economic growth. In order to prevent adverse effects on manufacturing, consumer spending, and distribution, fiscal measures such as taxation, public borrowing, and funding deficits, among others, must be employed wisely. It should boost the overall economy, which will raise both the national and per capita incomes.

#### 1.4.4 Optimum Allocation of Resources

The distribution of resources in specific businesses and professions can be greatly impacted by fiscal policies like taxation and government spending. Government incentives and subsidies can affect how resources are distributed through the designated routes. For instance, tax cuts and concessions can be quite effective in attracting resources to enterprises that are preferred. Conversely, high taxes may deplete resources in a particular industry.

#### 1.4.5 Equitable Distribution of Income and Wealth

Social justice should be provided by a government that pledged to provide for the wellbeing of its people by allocating wealth and financial resources proportionately. Both wealthy and developing nations can successfully employ fiscal policy to accomplish the highly desired goal of socialism. In order to accomplish this, a progressive tax structure can be quite helpful. Additionally, spending by the government facilitates the transfer of wealth from the rich to the poor.

#### 1.4.6 Economic Stability

Economic stability is yet another important objective of sound fiscal policy. In order to achieve this goal, full employment and roughly stable prices must be maintained. Deflation should be avoided and inflation should be kept under control. In summary, a growing nation's fiscal plan aims to achieve both stability and economic growth. At the same time that prices are being lowered, the forces driving the growth process must be reinforced. Fiscal policies promote sustainable economic growth during periods of transient global economic shifts. Economic stability is yet another important objective of sound fiscal policy. In order to achieve this goal, full employment and roughly stable prices must be maintained. Deflation should be avoided and inflation should be kept under control. In summary, a growing nation's fiscal plan aims to achieve both stability and economic growth. At the same time that prices are being lowered, the forces driving the growth process must be reinforced. Fiscal policies promote sustainable economic growth during periods of transient global economic shifts.

#### 1.4.7 Capital Formation

The fiscal plan also aims to increase the amount of capital investment in the public and private sectors. Developing countries have a very low percentage of capital formation due to both unemployment and low per capita income. The cyclical poverty is the main problem in these countries. As a result, fiscal policy is applied in a way that minimizes undesirable expenditure in developed nations by lowering consumption and promoting savings.

The aforementioned view suggests that the goals of fiscal policy are complementary rather than mutually exclusive.

### 1.5 The Divergences Between Fiscal Policy and Monetary Policy

i. While fiscal policy focuses on the ways the government spends and earns money, monetary policy concentrates on the total quantity of money in the country's economy.

ii. The executive and legislative branches of government historically determine fiscal policy. Central banks typically are in charge of monetary policy.

iii. The federal government modify fiscal policy by adjusting taxation and spending proportions with the objective to boost (or discourage) spending among consumers while maintaining an appropriate degree of employment and inflation. The crucial indicator in this case is the total market demand.

In order to change the amount of currency in circulation, Federal Reserve banks and other central banks around the world either buy or sell government securities. They also change interest rates and reserve ratios, which indicate how much money banks must always hold, in order to either encourage or discourage banks from lending.

### 1.6 Systems of Fiscal Policy

The government's decisions about taxation, resource collection, and consumption are all included in the fiscal policy. Several provisions of the Nigerian constitution allow for several fiscal policy frameworks. Section 80-88 delineates the federal government's financial processes and authorities, encompassing fiscal accountability, public fund management, and expenditure authorization. Again more clearly, section 16 of the Nigerian constitution sets out the economic

objectives of the state, providing a framework for fiscal policy objectives and strategic priorities. Moving forward to establish clarity to issues surrounding fiscal policy, the second schedule particularly items 7 and 50 of part 1, assigns legislative and executive powers between the three tiers of government (federal, state, and local government), influencing fiscal policy and revenue allocation. In expanding views, the chapter VIII of the constitution: Federal Capital Territory, Abuja and General Supplementary Provisions: These parts address financial management and control, as well as the authority and duties pertaining to public funds. Together, these elements offer a framework for overseeing public finances, guaranteeing accountability, and, of course, encouraging openness in government expenditures—all of which are critical for putting Nigeria's fiscal and monetary policies into action.

### 1.7 Fiscal Policy has Four Essential Parts, Categorized as Follows

#### 1.7.1 Taxation Policy

The government makes an effort to keep taxes natural and generates revenue by imposing both direct and indirect taxes while preserving price stability. Consequently, it is imperative that the authorities adhere to the rulings of the judiciary regarding taxes and impose suitable tax rates, including progressive taxation. This is due to two factors:

(a) The greater the amount of the tax, the lesser individual purchasing power is. This will result in lower investment and output.

(b) People will have more money because of the lower tax, which will lead to increased expenditure and consequently an increase in inflation.

#### 1.7.2 Expenditure Policy

Both revenue and capital expenditures are covered by the government's spending policy. Purchasing long-lasting assets or manufacturing technology that will generate business or extra revenue for the government is an example of a government capital expenditure. Revenue expenditures include costs like interest paid by the Indian government on all domestic and foreign loans, pensions, and wages paid to government employees that do not actually produce income from productive assets.

#### 1.7.3 Investment and Disinvestment Policy

Foreign direct investment (FDI), also known as foreign institutional investment (FII), and the disinvestment of government holdings in privately or publicly traded shares are both included in the term "investment and disinvestment policy."

#### 1.7.4 Debt / Surplus Management

When the government receives more money than it spends, there is a surplus. When the federal government's expenses exceed its revenue, a deficit arises. To make up the shortfall, the government has to borrow money from domestic or foreign sources. It can also print money to make up shortfalls.

### 1.8 Some Stylized Statistics of Foreign Nations on Fiscal Policy

In wealthy countries like the US, Canada, UK, Germany, and Japan, tax revenues and rates have been found to be procyclical, rising during economic expansions and falling during recessions. On the other hand, government expenditure on goods and services stays mostly constant, resulting in countercyclical deficits. These countries' data show this tendency, which offers emerging nations important information to help them make policy decisions.

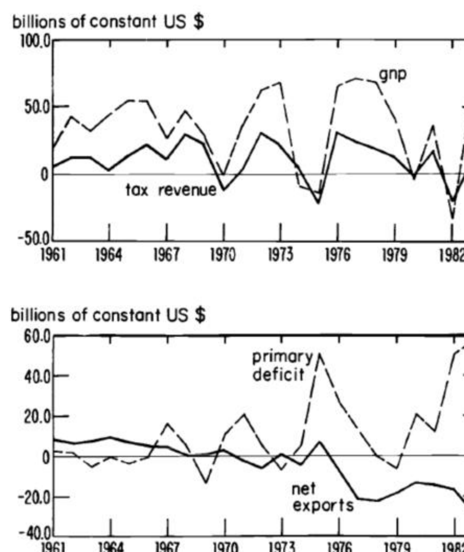


**Figure 2.** Statistics of Foreign Nations on Fiscal Policy

**The term "Expansionary" and Contractionary" is used the same way in relation to fiscal policy as to monetary policy.**

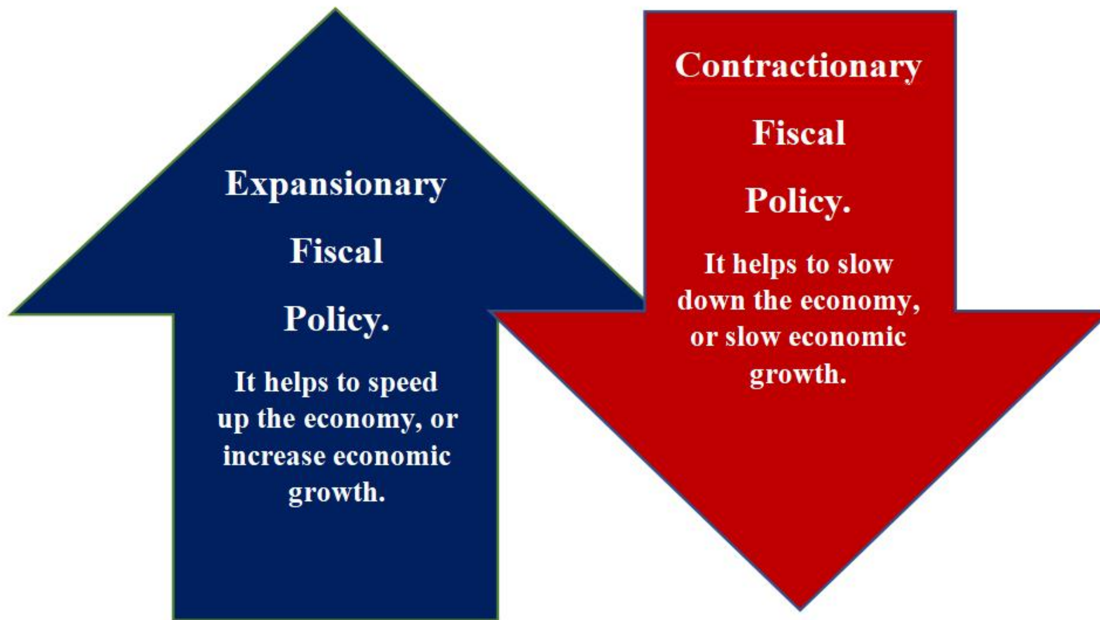


**Figure 3.** Expansionary and Contractionary Monetary Policy

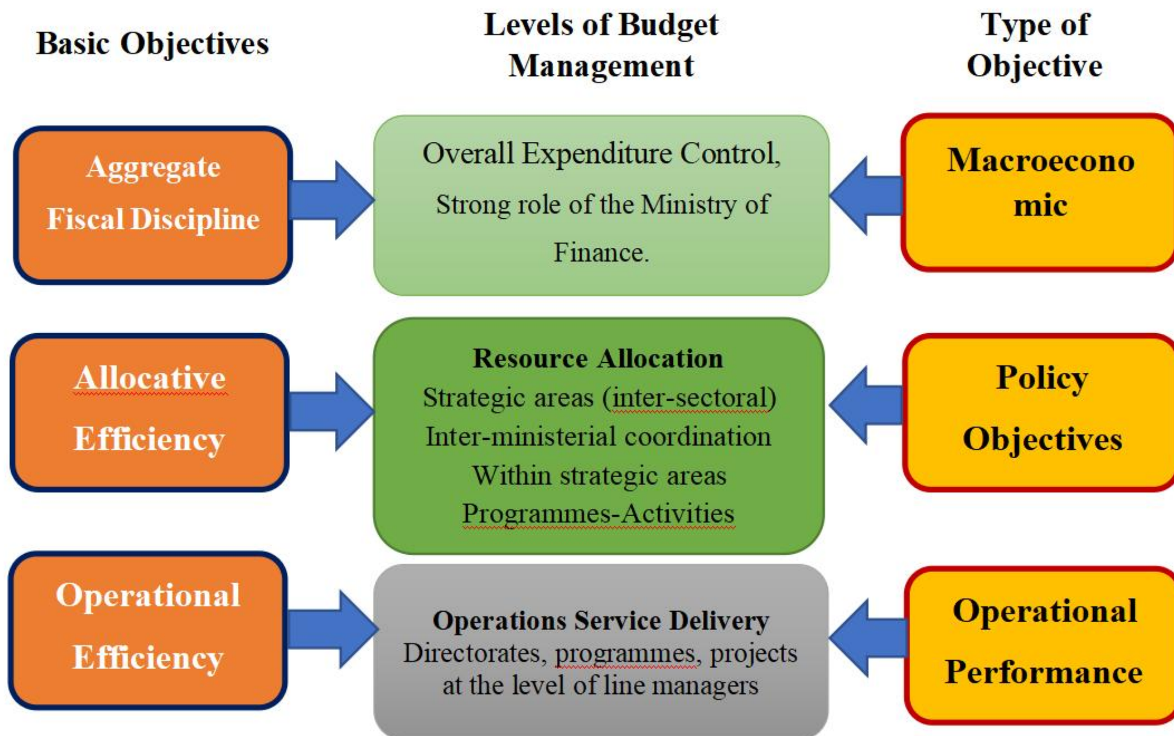


**Figure 4.** PFM Objectives, Budget Management and Macroeconomic and Fiscal Policy

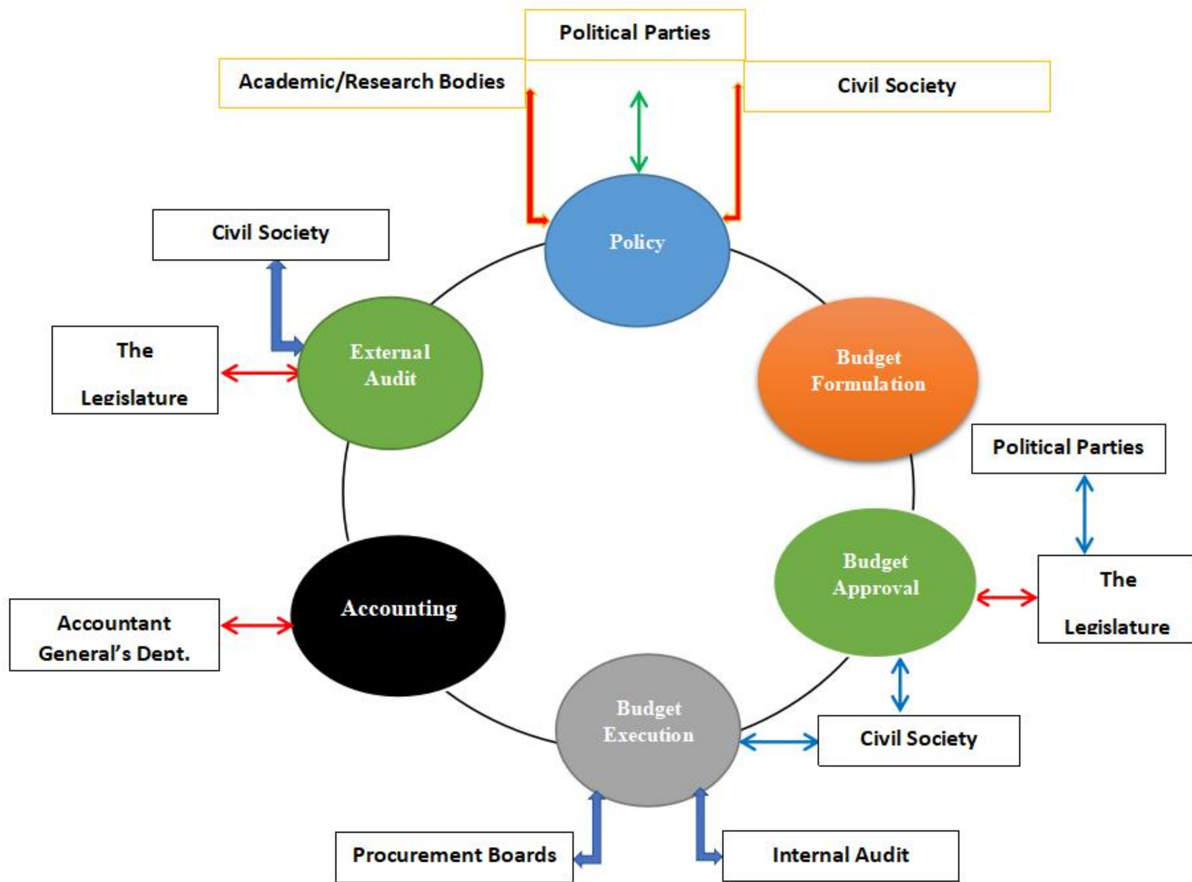


**Figure 5.** Public Financial Management and Fiscal Policy at a Glance

**Source:** Public Financial Management. GSDRC Professional Development Reading Pack

**Macroeconomic Policy Verses Fiscal Policy in Emerging Countries**

### 1.9 Fiscal Policy Adjustment and Economic Growth

IMF's support for fiscal adjustment may not always be sound, especially when macroeconomic imbalances are not primarily caused by fiscal concerns [4]. For economies that suffer large output losses during crises, fiscal policy relaxation might be a better course of action. Conversely, by improving market access, lowering interest rates, and fostering greater market trust, fiscal consolidation can improve GDP growth in countries with high public debt ratios and borrowing costs. In order to improve public finances, tighten fiscal policy, lower deficits and debt, and regain fiscal sustainability, many countries have embraced fiscal consolidation.

## 2. Literature Review

Keynesian economic theory was used in the investigation. Many people consider British economist John Maynard Keynes (1883–1946) to be among the most significant thinkers of the 20th century. Keynes played a significant role in the formation of macroeconomic theory and policy, and his theories still influence economic theory and practice today. Keynesian economics places a strong emphasis on the role that government action plays in keeping the economy stable, especially during recessions. Keynes believed that economic activity was largely determined by aggregate demand and that fiscal policy, which involves lowering taxes or raising government expenditure, could be used to boost economic growth.

Keynesian economic theory can be used in this publication to comprehend how Nigeria's fiscal policy affects economic growth. According to the theory, economic growth can be boosted by capital expenditure, public investment, and fiscal adjustment, especially in low-income countries that are dealing with macroeconomic imbalances. One possible weakness in the application of Keynesian economics to Nigeria is the presumption that the government has the means and ability to carry out efficient fiscal policies. Nigerian governments have really had to deal with issues including tax space constraints, poor infrastructure, and corruption, all of which can reduce the efficacy of fiscal policy.

### 2.1 Empirical Review

With an emphasis on emerging economies and comparisons to developed countries, the empirical study examines the circumstances in which fiscal consolidation results in equilibrium or increasing output. Fiscal consolidations are more

successful when debt is high or growing quickly because they encourage private sector investment [5]. The makeup of fiscal policy is important since the creation of the budget affects the responses and expansion of the private sector Fiscal policies based on cutting wages and transfers are more likely to be expansionary and long-lasting, whereas those focused on raising taxes and cutting public investment are more likely to be contractionary and unsustainable. Significant legislative reforms are necessary to reduce entitlement spending, such as health and pension costs, which can change the overall makeup of government spending.

There is little research on the immediate consequences of anti-cyclical fiscal policies in emerging countries. However, the impact of fiscal policy on economic activity is influenced by the distinctive characteristics of the institutions in emerging nations. Important distinctions include: restricted access to international finance markets, which makes accessibility and funding costs a major barrier. Significant budget deficits may result in inflationary pressures, crowding out effects, and the accumulation of unsustainable debt. These factors suggest that fiscal policy in developing countries can have distinct and potentially more severe consequences than in developed countries.

In contrast, a relatively high marginal likelihood of consumption may be anticipated to increase the fiscal multiplier's magnitude. Some have recently bemoaned the too strict fiscal policies of IMF-backed programs, which force developing countries to forgo economic growth in the name of fiscal restraint. Three questions were raised in conjunction with the empirical review of this study while dissecting the nature of fiscal policy, and they are listed below with scholarly insightful solutions [6].

i. What is the impact of the fiscal stance, expenditure composition, and budget financing on economic growth in developing countries?
ii. How do these and other factors affect the persistence of fiscal adjustments?
iii. Through which channels does fiscal consolidation affect growth?

### 2.2 Crucial Responses to the Critical Questions.

Baldacci, Gupta, Clements, and Mulas-Granados' research found that fiscal adjustment can promote economic growth in low-income countries with macroeconomic imbalances, similar to findings in developed countries [7]. They also found that boosting public investment spending by the government promotes economic expansion. Furthermore, their study shown that reducing certain current expenses produces higher growth rates than depending solely on revenue increases or reducing productive spending. Economic growth is best supported by fiscal measures that lower the financing of the domestic deficit, according to research. Stronger growth can coexist with higher current expenditures in countries with macroeconomic stability (low inflation and budget deficits) [8]. Fiscal changes, however, frequently don't persist long enough to significantly affect GDP. In order to optimize growth and advance the economy, fiscal consolidation must be maintained over time.

Therefore, the second important question is: What factors influence how long a fiscal adjustment program lasts?[9] A prolonged fiscal consolidation phase is caused by two reasons, according to research by Baldacci, Clements, Gupta, and Mulas-Granados: [1] protecting capital expenditure during fiscal adjustment, and [2] raising the proportion of current spending on non-wage goods and services. In low-income nations, these elements may support ongoing fiscal adjustment initiatives. Research indicates that while spending cuts have little effect in developing countries, fiscal consolidation is more likely to last when combined with increased revenue activities. This is in contrast to research in developed countries, where long-term budgetary adjustment depends on spending reduction. In industrialized nations, fiscal consolidation boosts growth through increased private investment, lower real interest rates, and improved stability.

However, the main way that fiscal adjustment stimulates growth in low-income nations is by influencing factor productivity. Because public expenditure productivity is low in countries with bad governance, fiscal adjustment is more crucial than the investment channel. Because of rent-seeking behaviour, changes in the spending structure that raise wages in the public sector and reduce capital spending might impede growth. Growth is best served by fiscal contractions that lower domestic borrowing [10].

## 3. Conclusion

Through more efficient responsibility and resource allocation, fiscal decentralization can enhance public service delivery and resource management. To do this, a robust legal framework and good public spending management principles are required. Nigeria continues to encounter formidable developmental obstacles, especially in the area of attaining growth that is equitable. Poverty reduction has been little despite economic growth and stabilization, which makes fair growth a key problem for the country's economic progress.

## 4. Recommendations

In Nigeria, lawmakers frequently have to choose between using public monies for their own benefit or political power and fostering equitable economic growth. Due to the challenging trade-offs this duality creates, poor policy results may ensue. Nigeria's experience with high poverty levels despite economic growth illustrates the challenge of balancing competing needs with limited resources. The country's fiscal policy faces constraints, including:

1. Limited resources (taxes, non-tax revenues, grants, loans, foreign investments)

2. Infinite citizen expectations (basic needs and wants)

3. Competing demands and wants for scarce resources

4. Contradictions, opposing interests, and coordination difficulties

To overcome these obstacles, the federal government should give the Central Bank of Nigeria (CBN) the authority to handle economic problems and put together a group of knowledgeable administrators and economists to correct imbalances in the economy and stop inflation.

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