The Impact of Government Revenue and Expenditure on the Economic Development of Cross River State, Nigeria

Ejoh, Ndifon Ojong¹, Okpa, Inah Bassey², Ogon, Akpeh Edung³

Abstract

Requirement of governments to provide public goods and execute other developmental projects that would improve living standard of citizenry as well as meet its recurrent expenditure necessitate intensified revenue generation efforts both internally and externally. Collection of taxes is one of the formidable options to generate revenue. Based on the backdrop, this paper set out to empirically examine the impact of public revenue (taxation) and government expenditure (spending) on the development of the Cross River economy. The theoretical underpinning of the paper is hinged on the Fiscal-synchronization hypothesis, Spend-and-tax hypothesis and the endogenous growth theory. With a sample size of 80 respondents, the study adopted the survey design with data tested using Regression model from SPSS. The result shows that there is a significant relationship between public revenue, government spending and economic development. It was thus recommended from the findings that the government should diversify their source of revenue in order to operate a stable revenue base to perform their spending and properly manage their capital and recurrent expenditure in a manner that will raise the state’s production capacity.

Keywords: Public Revenue, Government expenditure, Taxation, Infrastructure, economic development.

1. Introduction

Public revenue, mainly generated in state governments is principally derived from taxation. Meanwhile tax is a compulsory levy imposed by government on individuals and companies for the various legitimate function of the state. Tax is a necessary ingredient for civilization. The history of man has shown that man has to pay tax in one form or the other that is either in cash or in kind, initially to his chieftain and later on a form of organized government. No system or rules can be effective whether foreign or native unless it enjoys some measures of financial independence.

Revenue and perhaps human and technical resources constitute the major factors of any developmental project. However, revenue plays a leading role because human and technical resources are being driven by effective revenue mobilization.

Development is capital intensive and therefore depends mainly on availability of adequate revenue. Development refers to a sustained socio-economic transformation. It touches virtually every aspect of human endeavor. To the individual, self-development and actualization depends mainly on the level of income and prudence. In a business enterprise, development may reflect in expansion, market domination, enhanced staff welfare, improved product quality and quantity, consumer satisfaction etc. All these are dependent on the availability of capital and effective utilization of surpluses or profit revenues accruable to the firm.

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On the part of the government, development is measured in terms of the level of output, per capita income and the standard of living of its citizenry. Running of government at the federal, state or local level is capital intensive. This is because the government owes it as a duty to maintain law and order, develop the economy and provide essential services for the people. In the provision of these essential services attention has been shifted to the rural areas by all levels the government. This is perhaps in an attempt to balance the socio economic development of society. Thus one of the major focuses of the government today is the development of the rural areas. The success or failure of this programme will however, depend on effective and efficient revenue generation, mobilization, utilization and management. No wonder, effective and efficient revenue mobilization and sound fiscal policy is said to be a very serious business of the government.

Taxation revenue has been seen as a major source of government revenue all over the world. Government use tax proceeds to render their traditional functions, such as the provision of public goods, maintenance of law and order, defence against external aggression, regulation of trade and business to ensure social and economic maintenance.

However, it is evidenced that the role of taxation in promoting economic growth in Nigeria is not felt, primarily because of its poor administration. The major challenges facing tax administration in Nigeria include frontiers of professionalism, poor accountability, lack of awareness of the general public on the imperatives and benefits of taxation, corruption of tax officials, tax avoidance and evasion by taxing units, connivance of taxing officials with taxing population, high rate of tax, poor method of tax collection, etc. Tax administration and individual agencies suffer from limitations in manpower, money, tools and machinery to meet the ever increasing challenges and difficulties. In fact, the negative attitude of most tax collectors toward taxpayers can be linked to poor remuneration and motivation.

From the foregone, the thrust of this study is to examine the impact of public revenue (taxation) in the economic development of Cross River State.

- **Objectives of the Study**
  
  The objectives of this paper include the following:
  
  i. To investigate the relationship between taxation as a major source of public revenue and government expenditure.
  
  ii. To assess the degree of the impact of public revenue on the attainment of economic development in Cross River State.
  
  iii. To show the extent to which public revenue affects government spending

- **Research Hypotheses**

  This paper formulates two hypotheses for testing in null form
  
  Ho1: There is no significant relationship between public revenue and economic development
  
  Ho2: The level of public revenue available to the state does not determine the extent of government spending in that state.

- **Organization of the Study**

  The rest of the paper is organized in four sections. The review of relevant literature is contained in section two, section three identifies the research methodology, and section four represents data presentation, analysis and discussion of finding while conclusion and recommendations are stated in section five.

2. **Theoretical Framework**

  It is common knowledge that fiscal policies cannot bring about changes in long-run growth of output in a neoclassical growth model. The introduction of endogenous growth models that incorporate the
government sector has led to the opposite conclusion that fiscal policies can affect the long-run growth rate of an economy (Barro and Sala-i-Martin, 1992).

In models of endogenous growth, government policies can improve the factor allocation of the market due to market failure. As a result, private factor productivity and the accumulation of physical capital and human capital respectively can be increased. Public inputs, natural monopolies or spill-over effects are the main justifications for government provision. In theory, these publicly provided goods enter the production function so that they can boost the steady-state growth rate (Barro and Sala-i-Martin, 1992, for a clear theoretical exposition). Of course, there is some debate over the question of which particular expenditures should be classified as productive and which not (Kneller et al., 1999). Certainly, empirical studies should shed some light on this debate.

Several alternative models of government finance characterize the dynamic relation between expenditures and revenues. The tax-and-spend school, championed by Friedman views expenditures as adjusting, up or down, to whatever level can be supported by revenues (Friedman, 1978). This view implies a causal relation running from revenues to expenditures. The spend-and-tax model posits the reverse relation, with revenues responding to prior spending changes. Peacock and Wiseman see economic or political crises creating increased expenditure programmes that are subsequently ratified by tax increases (Peacock and Wiseman, 1979). Barro's tax-smoothing model also implies causation running from expenditures to revenues (Barro, 1979).

Within the public finance literature, it is often assumed that a government determines both revenues and expenditures in ways that maximize the social welfare of the society. However, four alternative hypotheses have been advanced to ascertain the nature of the causality between these variables in the budgetary process. The tax-and-spend argument proposes that changes in government revenues lead to changes in government expenditures. Friedman (1978) were early proponents of this view but differed in their perspectives. Friedman argued that increasing the resources available to government by increasing tax revenues will only lead to increases in government expenditures. The Friedman version of the tax-spend hypothesis suggests that government revenues have a positive effect on government expenditures. Alternatively, Buchanan and Wagner argued that increases in government revenues may lead to decreases in government expenditures through fiscal illusion. In particular, if the government is financing expenditures by means other than direct taxation, the fiscal illusion occurs because the public pays less in direct taxation but more in the form of indirect taxation (e.g., crowding-out effects and bracket creep caused by inflation). If indirect taxation declines while direct taxation increases, this trend could reduce government expenditures.

The spend-and-tax hypothesis suggests that a government first makes expenditure decisions and then adjusts tax policy and revenues as necessary to accommodate expenditures. From a Ricardian equivalence perspective, Barro (1979) argued that increased government expenditures financed by borrowing will translate into higher future tax liability for the public. In the context of fiscal policy response to "crisis" situations, temporary increases in government expenditures in response to such crises will lead to higher permanent taxes. Under either perspective, higher expenditures would lead to higher taxes.

Many recent studies have found that revenues and expenditures are cointegrated. The finding of cointegration implies that the standard UVAR specification is incorrectly specified, thereby casting doubt on the earlier causality test findings. (6) Numerous studies have yielded mixed results from applying the ECM as the dynamic specification for the cointegrating relationship between revenues and expenditures. For example, Bohn (1991), Mounts and Sowell (1997), Koren and Stiassny (1998), Garcia and Henin (1999), and Chang, Liu, and Caudill (2002) supported the tax-spend hypothesis whereas Jones and Joulfaian (1991) argued in favor of the spend-tax hypothesis.

Under the fiscal synchronization hypothesis, a government simultaneously chooses the desired package of spending programs and the revenues necessary to finance such spending programs. Musgrave (1966) and Meltzer and Richard (1981) are proponents of this view of the budgetary process. In addition, Miller and Russek (1989), Hasan and Sukar (1995), and Owoye (1995) found evidence to support the fiscal
synchronization hypothesis. Finally, under the institutional separation hypothesis, government decisions to spend are independent from decisions to tax. Hoover and Sheffrin (1992) and Baghestani and McNown (1994) have provided evidence of this view.

Wagner and Keynes propositions present two opposite perceptions in terms of the relationship between public expenditure and growth in national output. Peacock and Wiseman provide explanation to public expenditure growth and government revenue. While according to Wagner’s approach (1890) causality runs from growth in national output to public expenditure, the Keynesian approach assumes that causality runs from public expenditure to growth in national output in times of recessions.

The Role of Taxation on Economic Development and Sustainability

Chang, Liu, and Caudill (2002) stated that in achieving sustainable development in the social and economic sectors of a country, the government must consider the trade-off involved in attracting foreign direct investment (FDI) in terms of giving incentives and the impact of these on the country’s sustainable development. Tax is a fiscal instrument used to encourage or discourage specific production or consumption behaviours that affect the economic, environmental or social sustainability. Taxation has the following impacts on the sustainability of economic development:

(i) Tax system provides a fiscal platform that encourages foreign direct investment (FDI) and also fosters bilateral, regional and international trade relations among countries: The tax policies of a nation determine whether foreign direct investment would be attracted or not. If investors are brought into a country, it means that the investors will bring their stable and free capital, their technology, efficiency and contribution to nation’s capital accumulation and job/wealth creation.

(ii) Taxation fosters a fair relationship between development and developing countries so as to ensure that developing countries get a fair allocation of tax base and tax room in emerging trade relations: Consequently, the developed countries would not take undue advantage of the development needs in developing countries as a reason not to work out the international tax regime and mechanism against the third world countries.

(iii) Taxation helps developing countries in formulating effective policies and collection system that foster the funding of sustainability: Effective and well-functioning tax system and administration are an essential foundation blocks for financing sustainable development.

Therefore, if there is no adequate tax structure or tax collection system in place, it limits the ability of implementing any policy meant to enhance sustainable development goals and this may make developing countries to keep relying on foreign support which are usually attached with strings.

3. Empirical Review

A number of studies have focused on the relation between government expenditure (which is a function of government revenue) and economic growth in developed and developing countries like Nigeria. The results varied from one study to another. Alexander (1990) applied OLS method for sample of 13 Organization for Economic Cooperation and Development (OECD) countries panel during the period ranging from 1959 to 1984. The results show, among others, that growth of government spending has significant negative impact on economic growth.

Using panels of annual and period-averaged data for 22 Organizations for OECD countries during 1970 to 1995, Bleaney et al (2001) studied the impact of government spending on economic growth. Applying OLS and GLS methods, they found that productive public expenditures enhance economic growth, but non-productive public spending does not, in accordance with the predictions of Barro (1990) model.

Gemmell and Kneller (2001) provide empirical evidence on the impact of fiscal policy on long-run growth for European economy. Their study required that at least two of the taxation/expenditure/deficit
effects must be examined simultaneously and they employ panel and time series econometric techniques, including dealing with the endogeneity of fiscal policy. Their results indicate that while some public investment spending impacts positively on economic growth, consumption and social security spending have zero or negative growth effects.

Olorunfemi, (2008) studied the direction and strength of the relationship between public investment and economic growth in Nigeria, using time series data from 1975 to 2004 and observed that public expenditure impacted positively on economic growth and that there was no link between gross fixed capital formation and Gross Domestic Product. He averred that from disaggregated analysis, the result reveal that only 37.1% of government expenditure is devoted to capital expenditure while 62.9% share is to current expenditure.

Olopade and Olepade (2010) assess how fiscal and monetary policies influence economic growth and development. The essence of their study was to determine the components of government expenditure that enhance growth and development, identify those that do not and recommend those that should be cut or reduce to the barest minimum. The study employs an analytic framework based on economic models, statistical methods encompassing trends analysis and simple regression. They find no significant relationship between most of the components of expenditure and economic growth.

Abu and Abdullah (2010) investigates the relationship between government revenue and economic growth in Nigeria from the period ranging from 1970 to 2008. They used disaggregated analysis in an attempt to unravel the impact of government expenditure on economic growth. Their results reveal that government total capital expenditure, total recurrent expenditure and Education have negative effect on economic growth. On the contrary, government expenditure on transport, communication and health result in an increase in economic growth. They recommend that government should increase both capital expenditure and recurrent expenditure including expenditure on education as well as ensure that funds meant for development on these sectors are properly utilized. They also recommend that government should encourage and increase the funding of anti-corruption agencies in order to tackle the high level of corruption found in public offices in Nigeria.

In Nigeria, Akpan (2005) used a disaggregated approach to examine the relationship. Components of public expenditure considered in his analysis were capital, recurrent, administrative, economic service, social and community service, and transfers. The study found no significant relationship between economic growth and most components of government expenditure in Nigeria.

This study improves on some of the existing studies of Akpan (2005) in that it investigates the partial and joint effects of government expenditure on economic growth in Nigeria using certain disaggregated components of government expenditure. It also updates these studies in terms of currency and detailed analysis, and contributes to the existing literature on the long run relationship between government expenditure and economic growth in Nigeria. However, the study excludes administrative expenditure in that it is embedded in recurrent expenditures.

4. Research Methodology

This chapter provides a discussion of the research methods and procedures employed in this study. It discusses the research design especially with respect to the choice of design. It also discusses the population of the study, sample and sampling techniques, data collection methods as well as data analysis and data presentation methods employed in the study and highlight the sources of information for the research and data validation and integrity so that errors could be identified and eliminated during the analysis and interpretation.

This study employed the survey design with both primary and secondary data utilized. Primary data utilized self reporting Questionnaire on a drop and pick basis which was collected after the respondents filled it. 80 questionnaires were administered on the 80 sampled respondents randomly selected from the entire
population, out of which 60 were completed and returned. The secondary data were sourced from published and unpublished materials.

Regression analysis from IBM SPSS 20 was used to test the formulated hypotheses

5. Analysis and Findings

Hypothesis I

Ho: There is no significant relationship between public revenue and economic development

Regression

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<th>Variables Entered</th>
<th>Variables Removed</th>
<th>Method</th>
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a. Dependent Variable: Economic Growth
b. All requested variables entered.

Model Summary

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<tr>
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<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
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<td>.459</td>
<td>.450</td>
<td>.873</td>
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a. Predictors: (Constant), Public Revenue

ANOVA

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<th>Df</th>
<th>Mean Square</th>
<th>F</th>
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<td>58</td>
<td>.762</td>
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<tr>
<td>Total</td>
<td>81.733</td>
<td>59</td>
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a. Dependent Variable: Economic Growth
b. Predictors: (Constant), Public Revenue

Coefficients

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<thead>
<tr>
<th>Model</th>
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<th>Sig.</th>
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<td>(Constant)</td>
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<td>.398</td>
<td>3.142</td>
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<td>1 Public Revenue</td>
<td>.688</td>
<td>.098</td>
<td>7.020</td>
<td>.000</td>
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a. Dependent Variable: Economic Growth

Decision

In the model summary, the value of R Square value is 0.459 which reveals that Public Revenue alone accounts for over 46% variation in economic growth. Meaning that other factors collectively account for 54%. This is statistically significant.

The ANOVA table shows an F-ratio of 49.283 and a p value of 0.000 showing that the model is valid. The coefficients reveal that the t statistic value is 7.020 and a p value of 0.000.
Therefore, since the p value is less than 0.05, the null hypothesis is rejected and the research hypothesis upheld that there is a significant relationship between public revenue and economic development.

**Hypothesis II**

Ho: The level of public revenue available to the state does not determine the extent of government spending in that state.

**Regression**

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<th>Model</th>
<th>Variables Entered</th>
<th>Variables Removed</th>
<th>Method</th>
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</tbody>
</table>

<sup>a</sup> Dependent Variable: Government Spending  
<sup>b</sup> All requested variables entered.

**Model Summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
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<td>.392</td>
<td>.381</td>
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<sup>a</sup> Predictors: (Constant), Public Revenue

**ANOVA<sup>a</sup>**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
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<td>Total</td>
<td>98.733</td>
<td>59</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> Dependent Variable: Government Spending  
<sup>b</sup> Predictors: (Constant), Public Revenue

**Coefficients<sup>a</sup>**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
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<td>(Constant)</td>
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<td>.464</td>
<td>1.821</td>
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<tr>
<td></td>
<td>Public Revenue</td>
<td>.698</td>
<td>.114</td>
<td>6.109</td>
</tr>
</tbody>
</table>

<sup>a</sup> Dependent Variable: Government Spending

**Decision**

In the model summary, the value of R Square value is 0.392 which reveals that Public Revenue alone accounts for over 39% of public spending in the state. Meaning that other factors collectively influence over 61% of public spending.

The ANOVA table shows an F-ratio of 37.317 and a p value of 0.000 showing that the model is valid. The coefficients reveal that the t-statistic value is 6.109 and a p value of 0.000.
Therefore, since the p value is less than 0.05, the null hypothesis is rejected and the research hypothesis upheld that the level of public revenue available to the state determines the extent of government spending in that state

6. Conclusion and Recommendation

This study is undertaken primarily to determine the impact of public revenue in the development of the Cross River Economy. Despite the identification of taxation as one of the most reliable sources from which any government could derive the necessary revenue for her various development functions, Cross River State has been performing low in terms of tax yield. This is due majorly to several problems beclouding the system of tax administration in the state.

It has been emphasized that for development and growth of any society, the provision of basic infrastructure is quite necessary. This perhaps explains why the government shows great concern for a medium through which funds can be made available to achieve their set goals for the society. Government needs money to be able to execute its social obligations to the public and these social obligations include but not limited to the provision of infrastructure and social services. The need for adequacy of revenue at all levels of government has become imperative, given the expenditure profile of government aimed at reducing poverty, generating employment, boosting growth and creating wealth. Taxation has been advanced to be the major source of public revenue in this study.

The conclusion emerging from this study is that public revenue and expenditure is effective in promoting economic growth and development in Cross River State, government expenditure is tied to the availability of public funds and finance at the disposal of the state government since the higher the government spending, the higher the level of economic growth (ceteris paribus) and the lower the government spending, the lower the level of economic growth of the nation.

From the study, the following recommendations are made:

Since this research work posits that the public revenue and expenditure contributes significantly to the development of any economy, the government should diversify their sources of revenue in order to operate a stable revenue base to perform their spending.

There is need for government to ensure that tax policies are reviewed and updated regularly. This has the effect of bringing innovation in tax administration and effective revenue generation.

It is suggested that a further research be conducted on a larger scale, say using a country as the population.

References


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