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Government Size and Economic Growth: Testing the Non-Linear Hypothesis for Nigeria

Authors : R. Santos Alimi

Abstract : Using time-series techniques, this study empirically tested the validity of existing theory which stipulates there is a nonlinear relationship between government size and economic growth; such that government spending is growth-enhancing at low levels but growth-retarding at high levels, with the optimal size occurring somewhere in between. This study employed three estimation equations. First, for the size of government, two measures are considered as follows: (i) share of total expenditures to gross domestic product, (ii) share of recurrent expenditures to gross domestic product. Second, the study adopted real GDP (without government expenditure component), as a variant measure of economic growth other than the real total GDP, in estimating the optimal level of government expenditure. The study is based on annual Nigeria country-level data for the period 1970 to 2012. Estimation results show that the inverted U-shaped curve exists for the two measures of government size and the estimated optimum shares are 19.81% and 10.98%, respectively. Finally, with the adoption of real GDP (without government expenditure component), the optimum government size was found to be 12.58% of GDP. Our analysis shows that the actual share of government spending on average (2000 - 2012) is about 13.4%.This study adds to the literature confirming that the optimal government size exists not only for developed economies but also for developing economy like Nigeria. Thus, a public intervention threshold level that fosters economic growth is a reality; beyond this point economic growth should be left in the hands of the private sector. This finding has a significant implication for the appraisal of government spending and budgetary policy design.

Keywords : public expenditure, economic growth, optimum level, fully modified OLS
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