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GOVERNMENT EXPENDITURE AND UNEMPLOYMENT IN NIGERIA: AN EMPIRICAL ANALYSIS

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ABSTRACT

The paradox of rising trend of unemployment in Nigeria amid increasing government expenditures and increasing GDP growth (at least since 2000) calls for empirical investigation. Therefore, this paper attempts to empirically examine the relationship between unemployment and government expenditure in Nigeria. Descriptive statistics and time series econometrics are used to analyse the data obtained from CBN bulletins and NBS database. The descriptive statistics shows that the bulk of the unemployed are youths and people with not more than secondary education. Generally, unemployment is found to be trending upward and it is more chronic in the North - West, North- East and South -South geopolitical zones. The unit root tests show that almost all variables are integrated at order (1) while the Johansen cointegration test shows evidence of long run relationship. The final parsimonious Error Correction Model (ECM) result shows that both recurrent and capital government expenditures have no significant impact on unemployment in Nigeria. Instead, the shares of manufacturing and agricultural output in the GDP have significant impacts on the rate of unemployment. The former has negative impact while the later has a positive impact. This implies that fiscal policy cannot be an effective mechanism of reducing unemployment in Nigeria, rather an expansion of the country's manufacturing sector. We therefore, conclude that conducive environment should be created for the manufacturing sector to thrive.

Keywords: Government Expenditure, Gross Domestic Product, Macroeconomic Policies, Unemployment

JEL Classification: H50, E24

1.0. INTRODUCTION

In almost every economy and at almost any time, there is a large number of people who want and are searching for job but could not get one. Unemployment is a worldwide phenomenon. For example, in 2011, the rate of unemployment was about 9% in the United States and about 17% in the Euro zone. Within Africa, the economic giant of the continent, South Africa had about 25% of its active labour force unemployed in 2011. In Nigeria, the rate of unemployment is on the increase. In 1991, unemployment rate in the country was just 3.4% but rose to 13.4% in 2004 (NBS, 1991 and 2004). By 2009, it escalated to 19.7% and reached its peak of 23.9% in 2011 (NBS, 2011). One of the obvious consequences of this, is the deteriorating security situation in the country in recent times. Idle youths are purportedly impelled to serve as political thugs to desperate politicians while some others are engaged in militancy and other criminal activities as a means for survival. Unfortunately, the worsening security situation especially in the North sagged the level of investments and further exacerbated the unemployment crisis. In the manufacturing sector, the capacity utilization which improved substantially from 29.29% in 1995 to 56.5% in 2003, however declined to about 54% in 2007 (CBN, 2011).

The increasing trend of unemployment in Nigeria is being experienced amid upward swing in government spending and increasing growth of GDP. The GDP of Nigeria has been growing at a rate more than 5% since 2000. Real non-oil GDP equally experienced an annual average growth rate of 5.9% during the period 2000 to 2005. The business cycle theories have demonstrated that unemployment is counter-cyclical. Output moves in same direction with employment, thus, as output is growing the number of people getting jobs will be increasing, hence unemployment is expected to decline. In situation where the Okun's Law¹ holds a growth rate of more than 5% should have some reduction effects on unemployment.

In Keynesian macroeconomics, increase in government spending will lead to increase in aggregate output and by implication reduction in unemployment. Government expenditure is on the increase in Nigeria. For example the five year average of Federal Government expenditure was ₦194.33 million in 1965, ₦464.63 million in 1970. This jumped to ₦2,534.64 million in 1975, ₦9,411.14 million in 1980 and to ₦11,18.42 million, ₦33,457.68 million, ₦152,054.40 million, ₦525,690.28 million, ₦1,077,881.34 million and ₦2,849.847.98 million in 1985, 1990, 1995, 2000, 2005 and 2011, respectively. The state and local governments' spending equally increased throughout those periods (CBN, 2011).

One important research question that arises from this paradox is – what is the relationship between unemployment and government expenditure as well as real GDP growth in Nigeria? This question has not been accorded the requisite attention in the previous empirical studies on Nigeria. Therefore, the objective of this paper is to empirically examine the impact of government expenditure and real GDP on unemployment rate in Nigeria.

¹ Okun 1970 argued that a percent point growth of real GDP above the potential output should reduce the level of the rate of unemployment by 0.3 percent.

The remaining part of this paper, is divided into five sections. Section two contains a review of empirical literature, section three presents the theoretical framework and empirical model, while section four describes the data and, analyses the trend and composition of unemployment in Nigeria. Section five presents the results of the time series econometric analysis. Section six concludes the paper.

2.0. REVIEW OF LITERATURE

With the assumption of perfect competition implicit in neoclassical economics, this school of thought perceived level of employment as a function of real wages and unemployment as a temporary problem that could be purged by absolute reliance on the market forces. However in reality, wages do not respond automatically or through macroeconomic policies or microeconomic deregulations to clear the market (See Riveros and Bouton 1991). Thus, to the neoclassical economics and efficiency wage hypotheses, persistence of unemployment is attributable to inflexibility of wages in the labour market (See also Riveros and Bouton 1991), which could be the outcomes of stringent labour regulations and strong unions. Given this disposition, the best policies to curb the menace of unemployment are those that are capable of removing existing rigidities in the labour market and reduce the real wages.

However, the position of Keynes (1936) is that unemployment is determined by level of aggregate demand (Sawyer and Spencer, 2008). Hence, before Keynes' General Theory in 1936, fiscal policy had no place as a tool for fighting unemployment in an economy. The great depression of 1930s negated the classical economists' position and confirmed the Keynes' position. Since then, capitalist economies use fiscal policies to address unemployment problems. The contention of Marx's theory of unemployment is somehow different from both of Neoclassical and Keynes. It argued that, the amount of employment is determined by the amount of capital in existence and the technique of production. And that the growth of capital and development of new techniques often result into unemployment (see Furth et.al 1978 and Robinson, 1941).

In line with these theoretical underpinnings, numerous empirical analyses have been undertaken. For instance, Holden and Sparman (2011) using the data set of 20 OECD countries found that increased government purchases lead to lower unemployment. Similarly, Monacelli, Perotti and Trigari (2010), using US data also found that increased government spending generates more output and employment in the economy, while in Latin America and the Caribbean, the persistent increase in the rate of unemployment overtime, is largely accounted for by contraction in aggregate demand (Ball, Roux and Hofstetter, 2011). In Pakistan, a combination of rapid population growth, slow economic growth, fiscal indiscipline, rising debt servicing and non-development expenditure have aggravated the unemployment situation (Afzal and Awais, 2012). For South Africa, the rising trend of unemployment is attributed to the slow growth of the economy and existing rigidities in the labour market (Kingdon and Knight, 2007). But for Sri-Lanka, unrealistic expectations, excessive dependence on public sector jobs and stringent job regulation have combined to explain the unemployment situation overtime (Ram, 2003). Farmer and Plotnikov (2011) also found that increase in government spending can reduce unemployment. From this evidence, it suffices to conclude that the empirical causes of

unemployment are within the purviews of the neoclassical and Keynesian theories. But for Nigeria, Kakwugh and Ikwuba (2011) identified rapid population growth, high rate of geographical mobility and lack of unemployable skills as some of the causes of unemployment.

3.0 THE THEORETICAL FRAMEWORK AND MODEL

3.1 Theoretical Framework

The theoretical framework used in this paper follows a simple standard macroeconomics characterization of the medium run. By definition, the rate of unemployment is given as:

$$u = \frac{U}{L} \quad \text{-----} (1)$$

Where u is unemployment rate, U is number of people unemployed, and L is labour force. The number of people unemployed is defined as:

$$U = L - N \quad \text{-----} (2)$$

N is the number of people employed. Substituting (2) into (1) will yield:

$$u = 1 - \frac{N}{L} \quad \text{-----} (3)$$

From (3) number of people employed N can be defined as: $N = L(1 - u)$

Assuming labour is the only factor of production (since in the short or medium run capital is fixed) such that the production function is specified as: $Y = AN$ where Y is output, and A is technology. For the sake of simplicity, A is assumed to be constant and equal to unity, thus, the production function can be rewritten as:

$$Y = N \quad \text{-----} (4)$$

Equation (4) implies that the cost of producing one unit of output is equal to the cost of employing one more worker at wage W , where W is defined as:

$$W = P^e F(u, z) \quad \text{-----} (5)$$

Where P^e is expected price level and z is a catchall variable, that is, vector of all other factors that determine wages. If we assume that expected price equals actual price, then equation (5) can be rewritten as: $W = PF(u, z)$ dividing both side by P gives the real wage rate as:

$$\frac{W}{P} = F(u, z) \quad \text{-----} (6)$$

Equations (3), (4) and (6) describe the aggregate supply relation except the price setting equation that is missing which is not important in this paper. It is obvious to see here that unemployment is inversely related to output and positively related to real wage rate.

The aggregate demand function of the real sector is on the other hand defined as:

$$Y = C(Y - T) + I(Y, r) + G \quad \text{-----} \quad (7)$$

Where C is consumption expenditure, T is tax, I is investment expenditure, r is interest rate and G is government expenditure. This characterized aggregate demand of a closed economy without international trade. Implicit in equation (7) is that increase in government expenditure G will lead to reduction in unemployment through its impact on output Y .

3.2 Empirical Model

The empirical model is derived from the theoretical framework described above where unemployment rate is explicitly explained by level of output and real wages and implicitly explained by government expenditure and the catchall (z) variable. The real GDP is used to measure output, employees compensation is used to proxy real wage rate, two proxies are used to represent government expenditure, that is, share of federal government capital and recurrent expenditures. The shares of agriculture and manufacturing to GDP are used to capture the catchall z variable. The estimable model is, therefore, specified as:

$$UER_t = \alpha_1 + \alpha_2 SFRE_t + \alpha_3 FCEGDP_t + \alpha_4 RGDP_t + \alpha_5 AWR_t + \alpha_6 SMGDP_t + \alpha_7 SAGDP_t + u_t \quad \text{-----} \quad (7)$$

UER = Unemployment Rate, $SFRE$ = Share of Federal Government Recurrent Expenditure, $FCEGDP$ = Share of Federal Government Capital Expenditures in GDP, $RGDP$ = Real GDP, AWR = Annual Real Wages, $SMGDP$ = Share of Manufacturing in GDP, $SAGDP$ = Share of Agriculture in GDP and $u_t(t)$ = Stochastic Error term.

4.0 DATA AND ANALYSIS

The data on federal and state governments' expenditures, employee compensation and real GDP (at 1990 constant prices) are sourced from CBN Statistical Bulletin, 2011 while data on unemployment are sourced from ILO database and National Bureau of Statistics for different years. The data spanned from 1981 to 2010. Descriptive tools were used to analyse the trend and composition of unemployment in Nigeria while time series econometrics tools were used to test the unit root properties of the series and possible cointegration among them. The unit root properties of the series were tested based on ADF test which was confirmed with Phillip Peron test. Also, a test of cointegration was conducted based on Johansen procedure to examine whether the series are co-integrated or not in the long run. Thereafter, an over parameterized error correction model is estimated and the final Parsimonious Error Correction Model (ECM) is derived using the elimination procedure. The result of the tests and parsimonious ECM are presented and discussed in section five below.

4.1 Trend and Composition of Unemployment in Nigeria

The trend of unemployment presented in tables 4.1 to 4.5 covered the period of 1991 to 2010². The data has been partitioned into five year averages, that is, 1991 to 1995, 1996 to 2000, 2001 to

² Data on composition of unemployment for years 2008, 2009 and 2010 are not available in the NBS publications. Thus the average are computed based on the years for which data were available.

2005 and 2006 to 2010. The distribution of unemployment by levels of education and age group both in the rural and urban areas are presented in tables 4.1 to 4.3. Table 4.4 presents the gender distribution of unemployment while table 4.5 contains the distribution of unemployment across geopolitical zones.

There are large variations in the rates of unemployment across groups defined by educational qualification. The people with secondary education are the majority with the average unemployment rate of 49.0 % during the period of 1995 to 2000 and 57.7 % between 2006 to 2010 respectively. In all, people with not more than secondary education constitutes more than 80% of the unemployed people in Nigeria while people with post secondary education accounted for balance of less than 20% (See Table 4.1 – 4.3). The age distribution of the unemployment is also skewed. Majority of the unemployed people are those between the ages of 15 to 24, followed by those within ages of 25 to 44 years; while people between 45 and above are the minority. Although recently, the percentage distribution shows a gradual spread to older people but the pattern still portends high level of youth unemployment in the country (See Tables 4.1 – 4.3).

Table 4.1: Distribution of Unemployment (Urban & Rural Areas Combined) by Level of Education and Age Group in Nigeria, 1991-2010

Level of Education	No Schooling	Primary	Secondary	Post Secondary
1991-1995	17.6	20.6	55.8	6.0
1996-2000	23.1	13.0	49.0	14.9
2001-2005	13.86	17.3	57.76	11.12
2006-2010	12.8	15.3	63.7	8.2
Age Group	15-24	25-44	45-59	60- Above
1991-1995	65.4	24.4	10.1	-
1996-2000	43.6	42.5	9.0	5.0
2001-2005	54.38	36.18	4.06	5.36
2006-2010	55.2	36.1	7	1.7

Source: Authors' computation from NBS Publications for various Years.

Table 4.2: Distribution of Unemployment in Urban Areas by Level of Education and Age Group in Nigeria, 1991-2010.

Level of Education	No Schooling	Primary	Secondary	Post Secondary
1991-1995	13.4	14.0	67.1	5.5
1996-2000	9.1	11.8	62.0	17.1
2001-2005	11.04	16.56	53	19.4
2006-2010	19	17.1	46.1	17.8
Age Group	15-24	25-44	45-59	60- Above
1991-1995	67.0	24.5	8.4	
1996-2000	51.3	38.8	6.5	3.4
2001-2005	49.9	39	3.08	8.05
2006-2010	49.5	42.9	5.1	2.5

Source: Authors' computation from NBS Publications for various Years.

Table 4.3: Distribution of Unemployment in Rural Areas by Level of Education and Age Group in Nigeria, 1991-2010

Level of Education	No Schooling	Primary	Secondary	Post Secondary
1991-1995	19.0	21.3	53.0	6.7
1996-2000	22.9	17.0	49.2	11.0
2001-2005	16.7	15.9	56.2	11.2
2006-2010	18.7	15.3	52.6	13.4
Age Group	15-24	25-44	45-59	60- Above
1991-1995	65.1	24.5	10.5	0.0
1996-2000	50.8	37.1	8.7	4.3
2001-2005	55.43	36.7	3.7	4.2
2006-2010	55.1	38.5	3	3.4

Source: Authors' computation from NBS Publications for various Years.

The distribution of unemployment by gender has been stable overtime with males constituting an average of nearly 60%. Comparatively, the percentage share of female gender among the unemployed labour force is greater in urban areas than rural areas. However, overtime the overall share of females, although characterised by minor fluctuations showed a gradual rise probably due to increasing awareness and education among the female gender. (See Table 4.4)

Table 4.4: Distribution of Unemployment in Nigeria by Gender

Level of Education	Urban & Rural		Urban		Rural	
	Male	Female	Male	Female	Male	Female
1991-1995	59.22	40.78	55.48	44.36	60.02	39.98
1996-2000	59.83	40.10	56.64	43.36	57.64	42.36
2001-2005	57.54	42.46	57.46	42.54	57.33	42.67
2006-2010	57.70	42.30	53.70	46.30	58.90	41.10

Source: Authors' computation from NBS Publications for various Years.

Statistics also show that the rates of unemployment across states and geopolitical zones are increasing overtime (see Table 4.5). During the period of 2001 to 2005, the average rate of unemployment in the North Central was 4.8%, 8.8% in North East and 15.5% in North West while in the South East it stood at 11.4%, 9.5% for South-South and 4.5% for South West. However, between 2006 to 2010 this figures increased substantially. The unemployment rate in the North-East geopolitical zone has escalated to 18.6% while South West which had the lowest rate of 4.5% in 2001 to 2005 period recorded a substantial rise to about 10% in 2006 to 2010 period. The pattern of unemployment in the country across the geopolitical zones shows that the problem is worsening but more alarming in the North compared to the southern parts. And in the southern parts, the problem is more severe in South-South and South Eastern states than South West.

Table 4.5: Average Trend of Unemployment Across Geopolitical Zones in the Nigeria

Geopolitical Zone ¹	2001-2005	2006-2010
North-Central	4.8	15.1
North- East	8.8	18.6
North-West	15.5	17.3
South-East	11.4	14.4
South-South	9.5	16.9
South-West	4.5	10.0

Source: Computed from NBS 2011 Publications.

Generally, unemployment is more chronic in North-Western, North-Eastern and South-Southern states in which the cases of youth insurgencies under the auspices of different militia groups are incessant in recent times (See Table 4.5). This suggests a correlation to a large extent between unemployment and youth insurgence in the country. In Northern parts of the country, the North Western and Eastern geopolitical zones particularly Kano, Adamawa, Borno and Yobe have been engulfed by "*Boko Haram*" insurgence while uprisings caused by the Niger Delta militants and incessant cases of kidnaping are rampant in the South-South and South East geopolitical zones.

4.2 Discussion of Results

This section presents and discusses the results of unit root tests, cointegration test and the parsimonious error correction model (ECM). The results of ADF test indicate that all the series are $I(1)$ except SAGDP which is $I(0)$. Since the variables are unit root series, the coefficients of OLS regression will converge to a function of Brownian motion and the results will generally be inconsistent. However, the series seem not to drift away from each other, particularly those that exhibit $I(1)$ process. Therefore, there is no evidence of short run relationship between rate of unemployment and the explanatory variables in the model but there could be long run relationship among the series. Since the linear combination of $I(1)$ series could yield to stationary series. Thus, variable that show $I(1)$ process from the unit root test results are subjected to cointegration test. The cointegration test is the test for the existence of long equilibrium, that is, long run relationship between the dependent variable and the independent variables. The Johansen procedure of Cointegration rank test is used in this paper. The Trace and Maximum-Eigen Cointegration rank tests results are reported in Tables 5.2a & b. The Trace statistics and the Maximum-Eigen statistics indicate existence of at least one cointegrating equations. These suggest existence of long-run stable equilibrium of our unemployment model. Though, individually the series are not stationary, linear combination of them was found to be stationary. The existence of cointegrating relationship among the series is a convincing platform to proceed to the error correction model (ECM). The ECM fixed short run and long run dynamics together, it also include the speed of adjustment between the short run disequilibrium and long run

¹ Nigeria has been divided into six geopolitical zones as contained in Table 1.5. North central (Benue, Kogi, Kwara, Niger, Nasarawa, Plateau and FCT); North-East (Adamawa, Bauchi, Borno, Gombe, Taraba and Yobe); North-West (Kaduna, Katsina, Kano, Kebbi, Jigawa, Sokoto and Zamfara); South-West (Ekiti, Lagos, Ogun, Osun, Oyo and Ondo); South-East (Abia, Anambra, Ebonyi, Enugu, Imo); South-South (Akwa-Ibom, Bayelsa, Cross Rivers Delta, Edo and Rivers)

equilibrium. From the result of the estimated parsimonious error correction model (ECM) presented in Table 5.3, the ECM term is rightly signed with a coefficient of -0.423 indicating an evidence of long run convergence of the series, implying that about 40.23% of the error resulting from shocks is corrected annually. The result further shows that only two of the variables are significant and at second difference in the long run; they are the relative shares of manufacturing and agricultural outputs in GDP (SMGDP and SAGDP). The former has a negative impact on the rate of unemployment while the later has a positive impact. This suggests that the rate of unemployment in the country could be reduced by increasing the relative share of manufactured goods in the GDP. The positive impact of increased share of agricultural goods is fairly understandable as this might be due to greater use of mechanized and modern methods which require less labour.

Table 5.1: Result of ADF Unit Root Test

Variable	ADF Statistics	Order of Integration
UER	-5.3154*	I(1)
SFRE	-5.6033*	I(1)
FCEGDP	-3.4844*	I(0)
RGDP	-4.0659*	I(1)
AWE	-5.8497*	I(1)
SMGDP	-7.2994*	I(1)
SAGDP	-4.6448*	I(0)

Source: computed by authors, *significant at 1%, **significant at 5%, ***significant at 10%.

Result of the Johansen Cointegration Test

Table 5.2a Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of Ce(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob. **
None *	0.863218	141.3518	125.6154	0.0038
At most 1	0.646562	85.64962	95.75366	0.2021
At most 2	0.530246	56.52827	69.81889	0.3570
At most 3	0.449919	35.37298	47.85613	0.4285
At most 4	0.333465	18.63764	29.79707	0.5192
At most 5	0.216632	7.279076	15.49471	0.5454
At most 6	0.015690	0.442802	3.841466	0.5058

Trace test indicates 1 cointegrating eqn(s) at the 0.05 level,

Table 5.2b Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. Of Ce(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob. **
None *	0.863218	55.70222	46.23142	0.0037
At most 1	0.646562	29.12135	40.07757	0.4830
At most 2	0.530246	21.15529	33.87687	0.6725
At most 3	0.449919	16.73533	27.58434	0.6028
At most 4	0.333465	11.35857	21.13162	0.6115
At most 5	0.216632	6.836274	14.26460	0.5087
At most 6	0.015690	0.442802	3.841466	0.5058

Max-eigenvalue test indicates 1 cointegrating eqn(s) at the 0.05 level, * denotes rejection of the hypothesis at the 0.05 level, **MacKinnon-Haug-Michelis (1999) p-values

Table 5.3: Result of the Parsimonious Error Correction Model

Dependent Variable: UER (Unemployment Rate)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(SMGDP)	-0.6565	1.0306	-0.6370	0.5321
D(FCEGDP)	-0.1614	0.2577	-0.6264	0.5389
D(SAGDP)	-0.1708	0.1587	-1.0762	0.2960
D(AWR)	-0.1618	0.3424	-0.4727	0.6421
D(UER(-1))	0.2415	0.2371	1.0184	0.3220
D(SMGDP(-1))	-2.3267	1.0134	-2.2958	0.0339
D(FCEGDP(-1))	0.1118	0.3103	0.3602	0.7229
D(SAGDP(-1))	0.3787	0.1465	2.5841	0.0187
ECT1(-1)	-0.4278	0.1910	-2.2400	0.0380
C	-0.7984	0.8394	-0.9511	0.3541
R-squared	0.5215	Mean dependent variable		0.3429
Adjusted R-squared	0.2822	S.D. dependent variable		4.4041
S.E. of regression	3.7312	Akaike information criterion		5.7438
Sum squared residual	250.5989	Schwarz criterion	6.2196	
Log likelihood	-70.4133	Hannan-Quinn criterion		5.8893
F-statistic	2.1797	Durbin-Watson statistic		2.0578
Prob(F-statistic)	0.0795			

Source: Authors' computations

However, contrary to both neoclassical and Keynesian economics, neither public expenditures nor real wages have significant influence on the rate of unemployment in Nigeria. This suggests the existence of the endemic corruption and "rent seeking" activities in the public sector and imperfect nature of labour markets as clues for unemployment in the country. The former often results to missing funds in public procurement process while the later does not allow wage rate to be responsive to vagaries of demand and supply of labour, which lead to lower output.

5.0. CONCLUSIONS AND RECOMMENDATIONS

The conclusion from this study is that public expenditure composition and reviews of wages have no impact on the level of unemployment in Nigeria. These findings are not in accord with both the Keynesian and neoclassical theories. Unemployment in the country appeared as a consequence of the predominance of primary production in the structure of the economy. Therefore, neither fiscal policy via public expenditure composition nor wage policy is found to be an effective tool of addressing the menace of unemployment in Nigeria. The rate of unemployment in Nigeria could instead be reduced by changing the structure of the economy by specifically increasing the relative share of manufacturing output in the GDP. The positive impact of agricultural output on unemployment indicates that increasing agricultural output through mechanised farming may further exacerbate the unemployment crisis in the country at least in short and medium run.

The prevalence of endemic corruption and institutionalised rent seeking behaviour of public officials in the business of government and imperfect nature of the labour markets could be adduced as major factors undermining potency of public expenditure and real wage policies in controlling unemployment in the country. Therefore, it would be expedient to suggest that the government should renew its commitment to the fight against corruption and step up strategies that could boost production in the manufacturing sector of the Nigerian economy. These include

among others the development of physical infrastructures, restoration of security of life and property, encouraging small and medium scale manufacturing industries.

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