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Relationship between Government Expenditure and Economic Growth in Nigeria: Autoregressive Distributed Lag (ARDL) Bound Testing Approach

Lukman Lawali[1*], Abdullahi Yusuf[2]
Zamfara State University Talata Mafara
Corresponding Author: Lukman Lawali, lukmanmuhammadll@gmail.com

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A B S T R A C T

This paper uses the Autoregressive Distributed Lag (ARDL) and Vector Autoregression (VAR) frameworks to examine the relationship between government spending and economic growth in Nigeria from January 2008 to December 2023. The analysis makes use of monthly data on real GDP, total expenditure, capital expenditure, and recurrent expenditure. According to empirical results, while recurrent and capital expenditures are statistically significant, their effects on GDP are negative. The total government expenditure has an insignificant impact on economic growth. The ARDL bounds testing procedure confirms that the variables do not exhibit long-run co-integration. Furthermore, impulse response and variance decomposition analyses show that government spending has limited and declining effects on economic performance. These findings indicate that, despite increased public spending, its effectiveness in driving economic growth in Nigeria remains low, owing to inefficiencies, corruption, and poor project execution. To ensure a more growth-oriented fiscal policy framework, the study recommends stronger fiscal discipline, improved public financial management, reprioritising expenditure, and increased transparency and accountability in public spending

INTRODUCTION

Traditionally, government spending was divided into two categories: recurrent and capital. Musgrave (1989) defined the former as the government's purchase of current goods and services (labour, consumables, wages and salaries, etc.), whereas the latter would ideally include not only infrastructure investments (roads, schools, hospitals, etc.), but also all other expenditures that could contribute to development. In other words, recurrent expenditure refers to financial outlays required for the day-to-day operations of government businesses, whereas capital expenditure refers to investment opportunities that increase the state's assets. These classifications, however, were not mutually exclusive but rather interconnected. For example, while capital expenditure resulted in recurrent expenditure in the majority of cases due to the operational and maintenance costs of completed capital projects, the amount available for investment was determined not only by the size of revenue but also by the amount spent on government operations each year. (Abraham and Mike, 2014)

Nigerian government spending has risen due to high income from crude oil production and sales, as well as increased demand for public goods such as roads, agriculture, power, education, security, and health. Total government expenditure (capital and recurrent) and its components have risen steadily over the last two decades. For example, total government spending rose from N4,712 billion in 2011 to N4,989 billion in 2015, N12, 081 billion in 2020, and N14,393 billion in 2022. Nigeria experienced an economic downturn during this time due to dwindling oil revenue, on which the country relies for its survival.(Sunday, 2022)

Economic growth is defined as a consistent increase in national income or output per capita over time. Okerekeoti (2022) defined economic growth as the rate at which national output increases faster than population growth. It results in an increase in Real Gross Domestic Product GDP, which translates into increased national output and wealth. GDP is defined as the market capitalisation of all goods and services produced in a country over a given time period. Nigeria's GDP decreased by 1.6% and 1.8% between 2016 and 2020 as a result of falling oil revenue and the COVID-19 pandemic in 2020, but increased by 3.4% and 3.11% in 2021 and 2022, respectively. Despite declining revenue, the need for the creation of enabling and secure human and business environments is growing, resulting in increased spending on infrastructure, agriculture, security, and health in order to achieve consistent infrastructure development, human and food security, and a conducive environment for capitalists to operate. However, those massive spending has not translated into steady economic growth in Nigeria, as shown by the dwindling growth rate in the Gross Domestic Product in 2016 and 2020, while other years have shown an increase in growth rate (Trading Economic, 2022).

LITERATURE REVIEW

Recent research has reaffirmed the importance of input macroeconomic variables such as capital and recurrent expenditure, interest rates, and exchange rates in promoting economic development.

Adedeji et al. (2024) used the Auto Regression Distributed Lag (ARDL) method to examine the impact of government spending on Nigeria's economic growth over an annual time period from 1986 to 2021. The findings revealed that total capital expenditure was positive and insignificant, whereas total recurrent expenditure was positive and insignificant. Total expenditure was negative and insignificant, whereas domestic debt financing had a positive long-run relationship with GDP. The study concluded that government spending indices had an insignificant impact on economic growth in the long run.

Chen et al. (2024) argue that the relationship between interest rates and economic growth can be non-linear and influenced by global economic conditions. Their findings suggest that extremely low or negative interest rates can have diminishing returns and may not always result in proportional increases in economic growth (Chen, Lu, & Zhou, 2024). According to Ghosh et al. (2024), while exchange rate fluctuations can have an impact on growth, the effects differ significantly depending on the country's economic structure and exchange rate regime. Their research emphasises that flexible exchange rates can sometimes better absorb external shocks and support economic growth in the face of global economic uncertainty.

According to Basu and Maertens (2023), recurring expenditure on social services such as education and health can indirectly contribute to growth by improving human capital. They emphasise that investments in recurrent spending can improve labour force quality, resulting in increased productivity and economic growth in the long run.

Borio et al. (2023) argue that public investment in infrastructure can boost economic growth by increasing production efficiency and lowering business costs. According to their findings, well-targeted capital expenditure can significantly increase productivity and long-term economic growth, particularly in developing economies with significant infrastructure gaps.

Kiley (2023) demonstrates that low interest rates can boost economic growth by making borrowing more affordable, thereby encouraging investment and consumption. His research shows that, while low interest rates can boost growth in the short term, they can also lead to asset bubbles and financial instability if not managed properly.

Rogoff and Reinhart (2023) argue that exchange rate stability is critical for economic growth because large fluctuations can cause uncertainty in international trade and investment. Their research found that stable exchange rates promote long-term economic growth by creating a predictable business environment. Furceri and Karras (2022) discover that the relationship between capital expenditure and economic growth can be inconsistent, especially in countries with high levels of corruption or poor project management. Their findings show that, while capital expenditure has the potential to boost growth, its effectiveness is frequently hampered by implementation inefficiencies.

According to Auerbach and Gorodnichenko (2022), recurrent expenditure is critical for economic stability and consumer spending, but its direct impact on growth is less pronounced. According to their findings, while recurrent

spending can help to stabilise the economy and stimulate short-term economic activity, it does not always drive long-term growth.

A study conducted on Sunday, (2022) on the effect of government expenditure on economic growth discovered that government expenditure on agriculture, education, health, and security all have a positive and significant effect on Nigeria's GDP. The results provided further empirical evidence on the effect of government expenditure on critical sectors of the economy such as education, health, agriculture, and security as the most critical sectors that the government needs to pay more attention to in order to improve its GDP.

Bappahyaya et al. (2020) investigated the impact of government expenditure on economic growth in Nigeria using ARDL estimation. The study's findings indicate that in the long run, capital expenditure has an insignificant negative relationship with economic growth, whereas recurrent expenditure has a significant positive relationship with economic growth. Ifuruze and Ezeabasili (2020), using ARDL estimation, discovered that government expenditure on highways and safety has a significant positive effect on economic growth in Nigeria, whereas recurrent expenditure had an insignificant positive effect, and expenditure on education had a significant negative effect on economic growth. This implies that recurrent government spending in Nigeria contradicts economic growth.

According to the literature review above, while capital expenditure is widely regarded as a key driver of long-term growth, its effectiveness can be moderated by factors such as corruption and inefficiency. Recurrent expenditure is critical to economic stability but has little direct impact on growth. Interest rates have an impact on growth by influencing borrowing and investment decisions. Exchange rates impact growth by influencing trade and investment, with the effects varying depending on the exchange rate regime and economic context.

METHODOLOGY

This study uses monthly time-series data from January 2008 to December 2023 to investigate the relationship between government expenditure and Nigerian economic growth. The study's data sources include the Central Bank of Nigeria (CBN) statistical bulletin, the National Bureau of Statistics, and the World Bank. The study employs the ARDL bound testing approach to determine the presence of long-run relationships between variables with varying order of integration. However, an important requirement for applying ARDL is that the series not be I (2). Rather, the combination of I(0) and I(1) should support the use of the ARDL Bound testing method. As a result, Augmented Dickey Fuller (ADF) and Philips-Perron tests were used to determine whether the series are I(0) or I(1). If the hypothesis of no cointegration is rejected, we use the restricted ECM model to calculate the short-run dynamic effect and long-run equilibrium relationship between the variables. However, if the hypothesis of no co-integration is accepted, then unrestricted VAR should be applied.

Model specification

The function relationship among the variables is:

$$GDP=f(TEXP, CEXP, REXP)\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots(1)$$

After converting the variables into logarithm form, the model is modified as follows:

$$LGDP = f(LTEXP, LCEXP, LREXP)\ldots\ldots\ldots\ldots\ldots\ldots(2)$$

Thus, the ARDL regression model is specified as:

$$LGDP_t = \alpha 0 + \alpha 1 LGDP_{t-1} + \alpha 2 LTEXP_{t-1} + \alpha 3 LCEXP_{t-1} + \alpha 4 LREXP_{t-1} + \varepsilon t\ldots\ldots\ldots\ldots(3)$$

Where $\alpha 0$ is the constant term, and αi (i=1 to 4) are the parameters of the model. εt is the random error term which has to be serially independent.

Theoretical Framework

Government spending on infrastructure and public services contributes significantly to economic growth. According to traditional Keynesian economics, increasing government spending can boost demand, resulting in increased production and job creation (Keynes, 1936). However, recurring government spending, such as education and healthcare, is also important for long-term growth. Basu and Maertens (2023) argue that investing in social services promotes a healthier and more educated workforce, which increases productivity and supports long-term economic growth. However, Auerbach and Gorodnichenko (2022) point out that, while such spending is important for maintaining economic stability and supporting daily consumption, it may not have the same immediate or direct impact on growth as capital expenditure.

RESULTS AND DISCUSSION

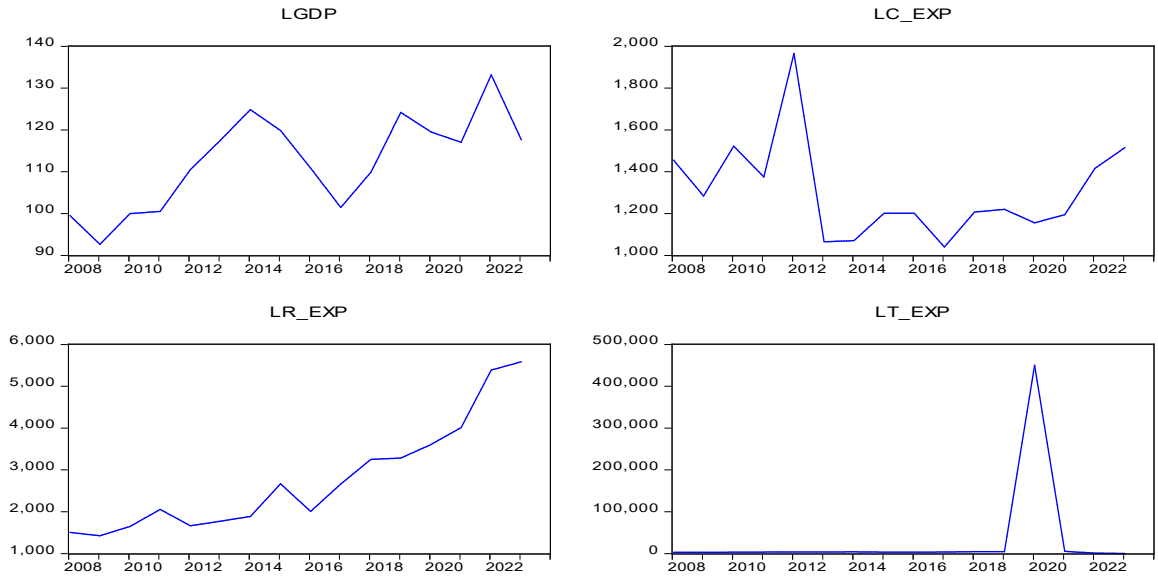

Figure 1. Below Shows a Graphical Representation of the Variables (Real GDP, Capital Expenditure, Recurrent Expenditure and Total Government Expenditure) from August 2008 to January 2023

From 2008 to 2023, the Gross Domestic Product (GDP), capital expenditure, recurrent expenditure, and total government expenditure all

followed a consistent pattern. LRDGP was rising very slowly, then exponentially, and then declined in 2013 to 2016. Capital and recurrent expenditure were trending upward, but slowly, from 2008 to 2020, 2022, before rising further and appearing to reach the peak point in 2022.

Table 1. Descriptive Statistics

	LGDP	**LTXP**	**LREXP**	**LCEXP**
Mean	112.6856	33082.12	2729.915	1294.752
Median	115.1972	3693.465	2335.365	1212.901
Maximum	133.1903	450353.0	5586.630	1965.300
Minimum	92.64215	115.5000	1426.060	1039.930
Std. Dev.	10.27843	89738.96	1187.862	193.0286
Skewness	-0.255456	3.140303	0.999284	1.144738
Kurtosis	1.932443	11.90621	3.005783	4.177807
Jarque-Bera	10.56368	895.6982	30.12374	49.99314
Probability	0.005083	0.000000	0.000000	0.000000
Sum	20396.09	5987865.	494114.5	234350.1
Sum Sq. Dev.	19016.32	1.45E+12	2.54E+08	6706806.
Observations	181	181	181	181

According to Table 4.1, LTXP and LREXP have higher mean, maximum, and minimum values than the other variables, as does the standard deviation. LCEXP and LGDP rank second and third, respectively. However, the negative skewness of LGDP, which also implies that the distribution has a long left tail, indicates that the distribution is left-skewed. A long right tail is visible as a result of the rightward skew in the distributions of the other variables. Furthermore, all variables except for LGDP have kurtosis greater than three, indicating that their distributions are more peaked than the normal distribution. LGDP, on the other hand, displays distinct kurtosis features. The Jarque-Bera test results show that all of the series, with the exception of LGDP, are not normally distributed, implying that they are significant at the 1% probability level, rejecting the null hypothesis for the distribution of LTXP, LREXP, and LCEXP. Hence, the variables cannot be described as normally distributed.

Table 2. Unit Root Test (Philipp-Perron and Augmented Dickey–Fuller)

Dickey-fuller GLS				**Philip-Perron**		
	Level 1 (0)	**First diff 1 (1)**	**I(D)**	**Level 1 (0)**	**First diff 1(1)**	**I(D)**
LGDP	-2.745**	----------	I (0)	----------	0.065*	I (1)
LTEXP	-3.284**	----------	I (0)	----------	0.024**	I (1)
LCEXP	----------	-2.713*	I (1)	----------	0.022**	I (1)
LREXP	----------	-2.702*	I (1)	----------	0.035**	I (1)

Note: *, **, denote the series are stationary at 5, and 10% significant levels
Source: Eviews Version 10 Computation by the Authors (2024)

The Dickey-Fuller GLS and PP unit root test results in Table 4.2 are consistent, indicating that all variables are integrated at order I (0) or I (1).

Meanwhile, no variable is integrated at order two (I(2)), meeting the requirement of the ARDL bound test.

Table 33 ARDL Regression
Dependent Variable: LGDP

Variable	Coefficient	Prob.*
LGDP(-1)	1.913781	0.000***
LGDP(-2)	-0.923014	0.000***
LTXP	-6.46E-08	0.800
LREXP	0.005068	0.000***
LREXP(-1)	-0.009601	0.000***
LREXP(-2)	0.004432	0.000***
LCEXP	0.009362	0.000***
LCEXP(-1)	-0.017906	0.000***
LCEXP(-2)	0.008727	0.000***
C	0.791756	0.038**
@TREND	0.003048	0.056**
R-squared	0.93	
Adjusted R-squared	0.92	

Note: *, **, *** indicate significant at 10%, 5% and 1% level respectively
Source: Authors' Computation with Eviews Version 10 (2024)

The above result can be writing as:

LGDP = 0.79 +1.913 LGDP(-1) -0.92 LGDP(-2) -6.46 LTXP+ 0.01 LTXP - 0.01LREXP(-1)+ 0.00 LREXP(-2)+ 0.01 LCEXP - 0.02 LCEXP(-1)+ 0.01 LCEXP(-2)

According to the probability values, all variables are statistically significant at 1%, with the exception of LTXP, which is insignificant. The estimated coefficients of recurrent and capital expenditure have shown evidence of a significant negative relationship with GDP, implying that a 1% increase in recurrent and capital expenditure will result in a decrease in GDP of (-0.09 and -0.01), respectively, while Total expenditure has an insignificant negative effect on GDP within the sample period. The ARDL regression result further shows a high R2 value (0.93) and adjusted R2 value (0.92), indicating that the model is a good fit, because 93% of the observed variation in the real GDP is accounted for by both positive and negative changes in the explanatory variables, namely total expenditure, capital expenditure, and recurrent expenditure.

Table 4. ARDL Bound Test Result

Test statistics	**Value**	**K**	**Significance**	**I (0) Lower Bound**	**I (1) Upper Bound**
F- statistics	2.803	3	10%	3.47	4.45
			5%	4.01	5.07
			1%	5.17	6.36

If the computed F statistic is less than the lower bounds, we can conclude that the variables are I(0), which means that no co-integration is possible. If the F statistics exceed the upper bounds, we can conclude that there is co-integration or that the variables are co-integrated I (1). If the F statistics fall within the bounds, the test is inconclusive. Because the F statistics value (1.087) is less than the lower bound even at a 10% level, all of our variables I (0) and I (1) are not co integrated. As a result, given that ARDL bound testing revealed that there is no long-run relationship between the variables of interest, the VAR model is the most appropriate. As a result, we proceed with the VAR model, which is explained using the VAR tools (Impulse response and variance decomposition).

Impulse Response Function (IRF) Graphs

The issue of non-exogeneity in some of the variables has been addressed using IRFs, which capture the variables' endogeneity. IRFs show the response of a particular variable to one standard deviation shock on each of the variables in the system

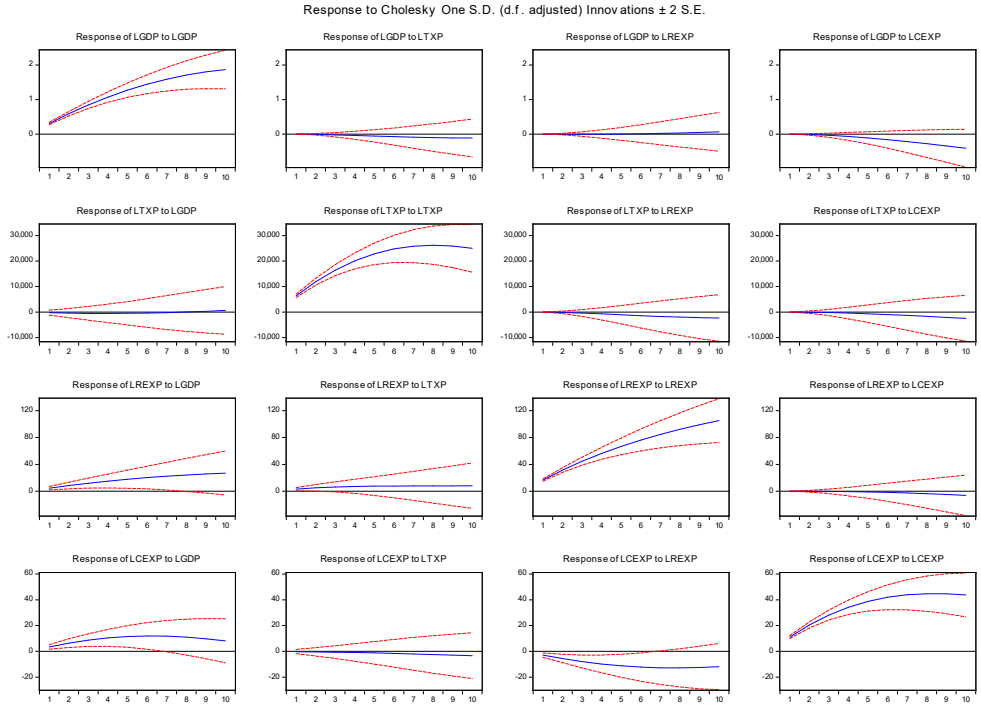

Figure 2. Impulse Response Function (IRF) Graphs

The impulse response function in the first raw showed the response of real GDP to a one-standard deviation (S.D) in any of the innovations (total expenditure, recurring expenditure, and capital expenditure in logarithm form). A one-standard deviation shock to LRGDP has a positive effect on itself, with an unsteady decline from the first to the last period of the forecast horizon. LRGDP's response to one standard deviation shock of LTXP has shown a steady increase in the second and third periods; however, from the fifth to the last period, LRGDP does not respond well to LTXP. A one-standard deviation shock to LREXP resulted in an expansionary response to LRGDP, which then declined

during the sixth to ninth periods. LRGDP responded negatively to a single S.D shock to LCEXP, implying that LCEXP has a negative effect on LRGDP.

Table 5. Variance Decomposition

Variance decomposition of LGDP				
Period	**LGDP**	**LTXP**	**LREXP**	**LCEXP**
1	0.307821	0.000000	0.000000	0.000000
2	0.589818	-0.007783	-0.000822	-0.011748
3	0.844818	-0.021017	-0.000989	-0.034740
4	1.072132	-0.037545	0.000563	-0.068091
5	1.271524	-0.055410	0.004539	-0.110613
6	1.443173	-0.072883	0.011334	-0.160902
7	1.587629	-0.088477	0.021081	-0.217408
8	1.705763	-0.100958	0.033700	-0.278507
9	1.798728	-0.109351	0.048942	-0.342552
10	1.867903	-0.112937	0.066429	-0.407933
Variance decomposition of LTXP				
1	-245.6004	6398.821	0.000000	0.000000
2	-421.2609	11891.71	-151.2491	-67.07930
3	-523.6137	16459.14	-405.6989	-202.8210
4	-551.9262	20103.94	-721.8831	-404.2769
5	-507.7648	22849.06	-1064.771	-664.8642
6	-394.6667	24735.04	-1405.522	-975.2379
7	-217.8200	25817.29	-1721.143	-1324.117
8	16.24425	26163.33	-1994.082	-1699.051
9	299.9469	25849.98	-2211.762	-2087.104
10	624.9406	24960.65	-2366.065	-2475.458
Variance decomposition of LREXP				
1	4.395017	2.939124	16.68229	0.000000
2	8.353562	4.964429	31.47748	-0.071400
3	11.89452	6.282288	44.63328	-0.264187
4	15.03805	7.074975	56.36206	-0.611469
5	17.80602	7.501431	66.84524	-1.132288
6	20.22225	7.698156	76.23731	-1.834195
7	22.31245	7.780235	84.66944	-2.715574
8	24.10412	7.842504	92.25275	-3.767725
9	25.62624	7.960844	99.08128	-4.976685
10	26.90889	8.193590	105.2345	-6.324823
Variance decomposition of LCEXP				
1	3.447735	-0.217005	-2.969756	11.13141
2	6.371673	-0.426826	-5.639947	20.50829
3	8.708754	-0.656067	-7.940539	28.18467
4	10.42171	-0.922593	-9.823845	34.24516
5	11.49671	-1.236209	-11.26230	38.79869
6	11.94069	-1.599582	-12.24607	41.97254
7	11.77859	-2.009329	-12.78063	43.90685
8	11.05044	-2.457195	-12.88431	44.74947
9	9.808473	-2.931269	-12.58589	44.65140

10	8.114331	-3.417173	-11.92227	43.76281

Source: Researcher's Computation using EVIEWS 10

The variance decomposition in the first section of table 6 above shows that a change in the total volume of recurrent expenditure in logarithmic form is the most important factor in determining a change in the log of real GDP. Recurrent expenditure has been reported to increase from the fifth year to the last year. However, the second section of the table shows that gross domestic product has significantly contributed to total expenditure, increasing from 16.24% in the eighth period to approximately 299.95% in the ninth period and 624.94% in the tenth period. Similarly, the variation in recurrent expenditure has been explained by the change in gross domestic product, which contributed approximately 4.40% to 26.91% between the first and tenth periods, as well as the change in total expenditure, which contributed significantly to the variations in recurrent expenditure, ranging from 2.94% to 8.19% between the first and tenth periods. Furthermore, the final section of the table shows that only gross domestic product contributed to variations in current expenditure, which ranged from 3.45% in the first year to 8.11% in the last year.

Table 6. Findings from Diagnostic Tests

Test	**Test statistics**	**Prob. value**
Normality (Jarque –Bera Test Statistics)	2.680(0.000)	Not applicable
Serial Correlation (Breusch - Godfrey LM Test)	176.893	0.000
Heteroscedasticity (Breusch – pagan – Godfrey)	13.928	0.000

The Jarque-Bera test statistic in the table above shows that the series are not normally distributed, as evidenced by the significant p-value (0.000). This results in the rejection of the null hypothesis, which states that the series has normal distribution. Furthermore, the Breusch-Godfrey serial correlations test showed that the LM version is statistically significant, indicating that the series are serially correlated at the 1% level. As a result, we reject the null hypothesis of no serial correlation and conclude that there is no autocorrelation among the error terms. The Breusch-Pagan-Godfrey heteroskedasticity test yields a large p-value, indicating statistical significance. This indicates that we reject the null hypothesis and conclude that the residual variance is not constant.

Test of stability

Stability tests were carried out using the plots of cumulative sums of squared residuals and cumulative sums of recursive residuals shown in Figure 3 below. The CUSUM test results show that the model is stable, as the lines remain within the 5 percent critical boundaries represented by the blue lines. The CUSUMQ plot shows that the model is unstable during the study period when the red line occasionally crosses the 5 percent critical upper and lower bounds.

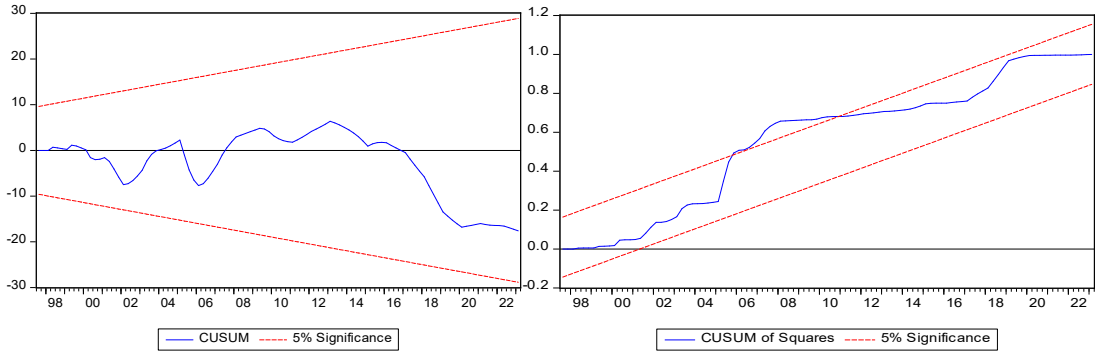

Figure 3. Plot of the CUSUM and CUSUM of Squares

Discussion of Findings (Supporting and Contradicting Previous Studies)

The empirical findings of the ARDL and VAR models show that recurrent and capital expenditure have significant but negative effects on Nigeria's economic growth, whereas total government expenditure is statistically insignificant. These findings have both supportive and contradictory implications when compared to previous studies discussed in the empirical literature.

Supportive Results:

Adedeji et al. (2024) discovered that both recurrent and capital expenditure were positive but insignificant, while total expenditure was negative and insignificant, which is consistent with the findings of this study regarding the insignificance of total government expenditure on GDP.

Furceri and Karras (2022) highlighted the ineffectiveness of capital expenditure in the presence of corruption and poor project implementation, which lends credence to the paper's findings. According to Auerbach and Gorodnichenko (2022), recurrent spending boosts short-term economic activity while having little impact on long-term growth. This nuanced view is supported by the study's negative long-run coefficient on recurrent expenditure.

The Impulse Response Function (IRF) and Variance Decomposition results confirm that while recurrent spending initially stimulates GDP, the effect fades over time, confirming the short-term benefits but long-term limitations of recurrent spending.

Contradictory Results

Sunday (2022) reported that government spending on education, health, security, and agriculture had a positive and significant impact on the GDP. This directly contradicts the negative coefficients discovered in this study for capital and recurring expenditures. Basu and Maertens (2023) emphasized that recurrent spending in social sectors such as education and health improves human capital and long-run productivity. The negative impact observed here indicates a disconnect, which could be caused by inefficiencies, misallocation, or corruption in Nigeria's public sector management.

Borio et al. (2023) emphasized the productivity-enhancing benefits of capital investment, particularly in developing countries. However, the study's finding of negative capital expenditure effects indicates that infrastructure

investments in Nigeria may be suboptimal or poorly executed. Overall, your findings are consistent with more recent and critical perspectives emphasizing inefficiencies in Nigerian public spending, but they contradict classical theories that expect government spending, particularly capital investment, to spur growth.

CONCLUSIONS AND RECOMMENDATIONS

The impact of government spending on Nigeria's economic growth was investigated using monthly data from 2008 to 2023 and the ARDL and VAR methodologies. The findings show that there is no long-run co-integration between government spending and economic growth based on the ARDL bounds test, and that total government expenditure (TEXP) is statistically insignificant in explaining variations in GDP, while capital (CEXP) and recurrent expenditure (REXP) both have statistically significant but negative effects on GDP. The findings highlight a fundamental inefficiency in the allocation and use of public funds. Government spending, while increasing, does not result in meaningful economic growth, pointing to issues such as corruption, bureaucratic bottlenecks, poor project implementation, and political misalignment of public investments. Based on the aforementioned findings, the following recommendations were made:

1. Improve Capital Project Implementation: In order to ensure productivity and sustainability, value-for-money audits and improved monitoring and evaluation of capital projects are urgently required.
2. Reprioritized Recurrent Expenditure: The government should rationalise recurrent spending to ensure that it supports critical sectors such as health and education in ways that boost human capital and output.
3. Combat Corruption and Waste: Public procurement and budget execution should be overhauled to reduce leaks and corruption, thereby increasing the impact of spending.
4. Improve Public Financial Management: To align public spending with development priorities, a framework that ensures transparency, accountability, and fiscal discipline should be implemented.
5. Involve the Private Sector via PPPs: To address inefficiencies in capital spending, the government should use Public-Private Partnerships (PPPs) to finance and manage infrastructure projects more efficiently.
6. Connect Budgeting to Performance Metrics: Budgetary allocations must be linked to output- and performance-based indicators, along with feedback mechanisms for policy adjustment.

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