THE IMPACT OF FISCAL POLICY ON PRIVATE INVESTMENT AND ECONOMIC GROWTH IN NIGERIA

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UNIVERSITI SAINS MALAYSIA

2021

THE IMPACT OF FISCAL POLICY ON PRIVATE INVESTMENT AND ECONOMIC GROWTH IN NIGERIA

by

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Thesis submitted in fulfilment of requirements
for the degree of
Doctor of Philosophy

March 2021

DEDICATION

This thesis is dedicated to Allah (SWT), the sponsor, the evolver, the sovereign and the essence of my life for guiding and sustaining me this far. All praise be to Allah for the gift of life, divine guidance and the precious opportunity He has given me to pursue a Doctorate Degree.

The thesis is also dedicated to the evergreen memory of my parent Alhaji Abdulkarim Ibrahim and Hajiya Hadiza Abdulkarim for their milk of human kindness and giving me the greatest gift, parent can give to their child- the desire to excel. They raised me with the fear of Allah and were willing to pay the supreme price to ensure that I excel. May Allah forgive their shortcoming and reward them with Jannatul firdaus (Ameen).

ACKNOWLEDGEMENT

I wish to express my wholehearted appreciation to my humble and erudite supervisor, Associate Professor, Dr. Saidatulakmal Mohd. for her inestimable contribution in writing this thesis. She went through this work severally with extreme thoroughness and diligence. Her mentorship, encouraging insight, comments and advice helped to give me direction on how to write a doctoral thesis that has improved the substance and quality of this work tremendously. Her timely responses and invaluable effort have mentored me into new economic reasoning especially on economic modelling, data handling, panel and time series econometric analysis. Her priceless contribution in the final and most important thesis writing stage has helped me to come up with strong arguments and to be brave in expressing the findings of this thesis.

I am also thankful to Professor, Dr. Andrew Tan Khee Guan, Associate Professor, Dr. Chua Soo Yean, Associate Professor, Dr. Loke Yiing Jia, Dr. Nor Asma Ismail and Dr. Law Chee Hong for their constructive criticisms, comments, recommendations and suggestions during my proposal defence. Their critique, comments and suggestions were invaluable in shaping and giving direction to this thesis. I also wish to thank all members of staff of the school of social sciences too numerous to mention for helping me to acclimatize and making life so pleasant in USM over the last couple of years. I cannot forget to acknowledge the administration of USM for giving me this golden opportunity to pursue a doctorate degree programme in Malaysia.

I am greatly indebted to my late mother Hajiya Hadiza Abdulkarim, for my proper upbringing, profound show of affection, zealous care, firmness, understanding and encouragement. She spurred, nurtured and facilitated my learning and made it a duty to ensure that I attain the best possible in life. May Allah make her grave a place of comfort and light. I would also like to express my profound gratitude to my family for the support they have given me. My brothers and sisters have always encouraged me to pursue my dreams to the end. I hope to make them proud of me, as they have always made me proud of them. My sincere appreciation goes to my wife Hasiya Hassan and my daughters Nana Firdausi, Maryam and Amira and son Amir for the moral and material support I received from them during the time I was busy compiling this work. They understood my absence and gave me a lot of support and encouragement which I needed to succeed during the period of adversity. I will not fail to notice the great support I received from my contemporaries at the School of Social Sciences, fellow international students and the general university community of USM. I thank you all for this wonderful and memorable didactic experience.

TABLE OF CONTENTS

LIST OF TABLES

Page

LIST OF FIGURES

Page

LIST OF ABBREVIATIONS

ADF	Augmented Dickey-Fuller
ARDL	Auto-Regressive Distributed Lag
CAMA	Companies and Allied Matters Act
CED	Customs and Excise Duties
CBN	Central Bank of Nigeria
CGT	Capital Gains Tax
CIT	Corporate Income Tax
CITA	Company Income Tax Act
CITN	Chartered Institute of Taxation of Nigeria
DMO	Debt Management Office
ECM	Error Correction Model
ECOWAS	Economic Community of West African States
EEG	Export Expansion Grant
FBIR	Federal Board of Inland Revenue
FCS	Fiscal Stance
FCT	Federal Capital Territory, Abuja, Nigeria
FDI	Foreign Direct Investment
FIRS	Federal Inland Revenue Service
GCE	Government Capital Expenditure
GDD	Government Domestic Debts
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GPI	Genuine Progress Index
GRE	Government Recurrent Expenditure
HDI	Human Development Index

HPI	Happy Planet Index
IMF	International Monetary Fund
JOA	Joint Operating Agreements
JVC	Joint Venture Contracts
LBF	Labour Force
MBPD	Million Barrels Per Day
MOU	Memorandum of Understanding
NBS	National Bureau of Statistics
NEEDS	National Economic Empowerment and Development Strategy.
NIPC	Nigerian Investment Promotion Commission.
NNPC	Nigerian National Petroleum Corporation
OECD	Organization for Economic Co-operation and Development
OLS	Ordinary Least Squares
PAYE	Pay-As-You-Earn
PED	Public External Debt
PIT	Personal Income Tax
PITA	Personal Income Tax Act
PPT	Petroleum Profit Tax
PSC	Production Sharing Contracts
RGDP	Real Gross Domestic Product
SAP	Structural Adjustment Programme
SBIR	State Board of Internal Revenue
SOEs	State Owned Enterprises
TSA	Treasury Single Account
USD	United States of American Dollars
VAT	Value Added Tax
VAIDS	Voluntary Assets and Income Declaration Scheme

IMPAK DASAR FISKAL TERHADAP PELABURAN SWASTA DAN PERTUMBUHAN EKONOMI DI NIGERIA

ABSTRAK

Dalam literatur, tiada cukai perbelanjaan kerajaan atau defisit yang berkolerasi dengan pertumbuhan ekonomi apabila dinilai secara individu. Kekurangan kolerasi boleh berpunca dari ketidakmampuan faktor belanjawan bagi menentukan pendirian dasar fiscal. Berdasarkan bukti penemuan kajian literatur sebelumnya yang membolehkan pengagregatan pemboleh ubah dasar fiskal yang lebih mendalam, tesis ini memfokuskan kombinasi petunjuk fiskal berpasangan, menyelidiki pengaruh dasar fiskal terhadap pelaburan swasta dan pertumbuhan ekonomi di Nigeria menggunakan data tahunan dari tahun 1980 hingga 2017. Walaupun kajian tentang perkaitan linear antara pemboleh ubah dasar fiskal dan pertumbuhan ekonomi telah dilakukan, kajian terkini strategi empirik adalah berbeza daripada pendekatan yang ada dan kesan pemboleh ubah simetri dan asimetri dikenal pasti menggunakan kaedah ARDL linear dan tidak linear untuk menilai kehadiran atau sebarang perkaitan jangka panjang dan penyebabnya. Berdasarkan bukti empirikal, cukai langsung menunjukkan kesan negatif yang signifikan ke atas pelaburan swasta dan pertumbuhan ekonomi, sementara cukai tidak langsung menghasilkan kesan positif yang signifikan ke atas pelaburan swasta dan pertumbuhan ekonomi. Perbelanjaan berulang melambatkan pelaburan swasta tetapi mendorong pertumbuhan, manakala perbelanjaan modal mendorong pelaburan swasta tetapi menyekat pertumbuhan ekonomi. Bagi hutang awam yang diasingkan, hutang domestik dikaitkan dengan kesan positif yang tidak signifikan terhadap pelaburan swasta dan kesan buruk yang signifikan terhadap pertumbuhannya. Hutang luaran memberi kesan buruk terhadap pelaburan dan pertumbuhan swasta.

Kadar inflasi dan liberalisasi ekonomi menggalakan pengaruh positif yang kuat terhadap pelaburan swasta sementara sikap fiskal mencetuskan kesan negatif yang signifikan terhadap pertumbuhan ekonomi. Secara keseluruhan, kajian mendapati bahawa model ARDL linear didapati lebih baik dan menunjukkan kemampuan ramalan yang lebih baik sesuai dengan dinamika pertumbuhan ekonomi Nigeria berbanding dengan anggaran NARDL. *Pairwise Granger Causality* mengenal pasti perkaitan searah *(uni-directional)* antara komponen terpisah iaitu pendapatan kerajaan, perbelanjaan berulang, hutang luar negeri dan pertumbuhan ekonomi berpunca dari pemboleh ubah dasar fiskal yang dikenal pasti untuk pertumbuhan ekonomi. Perkaitan bebas dikenal pasti antara perbelanjaan modal dan pertumbuhan ekonomi manakala hubungan dua arah *(bi-directional)* terhasil antara hutang domestik dan pertumbuhan ekonomi. Untuk mencapai kadar pertumbuhan yang mampan dan lebih tinggi, kajian menyarankan agar pengurusan dasar fiskal memfokuskan pada pemulihan kestabilan fiskal dengan memperluaskan dasar pendapatan melalui sistem pentadbiran dan kutipan cukai yang cekap, meningkatkan pelaburan dalam sektor produktif ekonomi, membatasi pembiayaan defisit berlebihan dan pelaburan pinjaman awam yang produktif untuk merangsang pelaburan swasta dan pertumbuhan ekonomi. Penggunaan teknik estimasi *Quantile ARDL* untuk mengkaji kesan asimetrik pemboleh ubah dasar fiskal terhadap pertumbuhan ekonomi menggunakan set data jangka masa panjang juga disarankan bagi penyelidikan masa depan.

THE IMPACT OF FISCAL POLICY ON PRIVATE INVESTMENT AND ECONOMIC GROWTH IN NIGERIA

ABSTRACT

In the literature neither taxes, government spending nor deficits are robustly correlated with economic growth when evaluated individually. The lack of correlation can emerge from the inability of any single budgetary factor to completely capture the stance of fiscal policy. Confirming the findings of previous literature, thus allowing for a more in-depth disaggregation of fiscal policy variables, this thesis, focused on the pair-wise combination of fiscal indicators, investigated the effect of fiscal policy on private investment and economic growth in Nigeria using annual data from 1980 to 2017. Although studies on the linear relationship between fiscal policy variables and economic growth have been developed in the past, the empirical strategy of the current research departs from this approach and explored the symmetrical and asymmetrical effects of the variables tested using linear and nonlinear ARDL methods to assess the presence or otherwise of any long-term relationship and the direction of causality between them. Based on empirical evidence, direct taxes prompted a significant negative effect on private investment and economic growth, while indirect taxes produced a significant positive impact on private investment and economic growth. Recurrent expenditure decelerated private investment but stimulated growth, while capital expenditure encouraged private investment but suppressed economic growth. For disaggregated public debt, domestic debt was associated with an insignificant positive impact on private investment and a significant adverse effect on growth. External debt had a detrimental effect on private investment and growth. Inflation rate and economic liberalisation both stimulated a strong positive influence

on private investment while fiscal stance triggered a significant negative impact on economic growth. Overall, however, the findings of the linear ARDL model were more impressive and showed a better predictive ability suited to the growth dynamics of the Nigerian economy compared to NARDL estimates. The pairwise Granger causality results detected a uni-directional relationship among disaggregated components of government revenue, recurrent expenditure, external debt and economic growth, with causality running from the acknowledged fiscal policy variables to economic growth. An independent relationship was identified between capital expenditure and economic growth while a bi-directional causal relationship was established between domestic debt and economic growth. To achieve sustainable and higher growth rates, the study recommended that fiscal policy management should focus on restoring fiscal stability by expanding the revenue base through an efficient tax administration and collection system, increasing investment in productive sectors of the economy, curtailing excessive deficit financing and productive investment of public borrowing in stimulating private investment and economic growth. The use of Quantile ARDL estimation technique to investigate the asymmetric impact of fiscal policy variables on economic growth using longer period dataset was also suggested for future researches.

CHAPTER 1

INTRODUCTION

1.1 Background of Study

Fiscal policy is concerned with the overall levels and broad composition of taxes, government spending and borrowing and their effects on the aggregate economy. It is one of the macroeconomic policy instruments that can be used to avoid or minimize short-term volatility in production, income, and employment in order to shift an economy to its long- term steady-state growth (Alesina and Ardagna, 2013). The specific fiscal problems facing oil-producing countries like Nigeria stem from the fact that oil revenues are exhaustible, unpredictable, unstable, and predominantly global. The unpredictability of oil revenues complicates macroeconomic management and fiscal planning, with the challenge being to avoid transmitting the oil price volatility, which is outside the control of policy makers into the macroeconomy. The reliance of government revenue on uncertain, unpredictable, and exhaustible oil revenues poses great concerns related to fiscal management and sustainability in the short and long term (Barnett and Ossowski, 2002).

The Nigerian economy is overwhelmed by structural deficiencies that restrict its ability to sustain growth, create jobs and reduce extreme poverty (Udoma, 2016). Buoyant oil revenues in the 1970s provided a basis for considerable yet unsustainable revenues and increased government spending. At the time, expansionary monetary and fiscal policies helped to increase government participation in economic activities. As a result, the economy became heavily reliant on crude oil for commercial, fiscal revenues and foreign exchange operations, neglecting the agricultural and solid mineral sectors that would have expanded the tax base of the country (Ogunjimi,

2019). Productivity in the non-oil sector of the economy was adversely affected. Conventional wisdom suggests that the symptoms of Dutch disease syndrome are manifest in the Nigeria economy given the combination of its resource abundance and low economic performance in the decades after the discovery of oil (Oriakhi & Iyoha, 2013).

A key item of the natural wealth of Nigeria is crude oil, which is simultaneously the country's main export commodity. The average annual price of oil per barrel has been growing since 1970. Nigeria reached a very high growth performance during the 1970s when the country experienced its first oil boom. The global oil market glut at the beginning of the 1980s exposed the vulnerability of the Nigerian economy to global oil market calamity and the unpreparedness to withstand a sustained period of low world oil prices (Saibu and Apanisile 2013). The economy was again associated with solid growth at an average of around 6 to 7 percent for about a decade and half of the new millennium. Then came 2014-2015, when the country witnessed collapsing growth because of exogenous shocks of oil price collapse. In 2014-2015, the price of crude oil rapidly declined from 108.8 USD per barrel in September 2013 to 29.8 USD per barrel in January 2016. It caused a dramatic drop in GDP per capita by 17.06 percent between years 2014 and 2015. This revealed that the effects of commodity booms can quickly wear off (Adela, 2017).

The manifestations of the resource curse syndrome have exposed the Nigerian economy to the short-run movement of prices, exchange rate and even economic growth. High volatility of these indicators makes the decisions of public authorities more difficult and raises an uncertainty for private entities (Ploeg and Poelhekke, 2009). In Nigeria, ethnic groups have been fighting over the control of natural resources and revenues from oil constantly while the competitiveness of other

economic sectors have decline significantly over the past few decades. There is also a low level of environmental protection while public authorities do not invest enough resources in the education sector (Odhiambo and Olushola. 2018). Advocates of the resource curse syndrome further argue that revenues from natural resources are positively associated with authoritarianism.

The reason is that revenues from natural resources exempts the government from the need to raise revenue through an efficient domestic tax administration and collection system. This explanation is associated with rent seeking which distorts resource allocation, reduce economic efficiency, leads to a higher level of corruption, and weaken the efficiency of fiscal policy (Saibu and Apanisile 2013). In general, a sudden resource bonanza tends to erode critical faculties of politicians and induce a false sense of security. This encourages them to invest in projects that are unnecessary, keep bad policies in force, and dress up the welfare state so that it is impossible to finance once natural resource revenues dry up. Politicians are likely to lose sight of growth-promoting policies, free trade, and value for money management. In addition, politicians are also prone to increases in public spending during period of resource boom (Ploeg, 2011).

Of importance to Nigeria is the unpredictable nature of oil prices in the world market. There is considerable uncertainty facing the government of an oil exporting country concerning its export earnings and fiscal revenues. The non-sustainability of revenue paths for oil exporting countries makes government planning extremely inefficient for growth and development. Okonjo-Iweala (2005) observed that there are two channels through which volatility can be transmitted domestically to the Nigerian economy through the oil market. First, negative oil price shocks by reducing government revenue essentially decreases government spending efficiency. Second,

oil price instability creates an atmosphere of uncertainty, repelling private investment. This instability has adversely affected Nigeria's historic growth record, as well as fiscal management and efficiency over the years. To this end, Ofoegbu et al (2016) admonished governments to seek for more reliable ways to generate revenue to prevaricate the economy from repeated shocks on the oil market.

Taxes are one of the major sources of revenue for funding government spending worldwide. Government collect taxes to carry out various activities that would improve their citizens' livelihoods through long-term economic growth (Raifu and Raheem, 2018). Sustainable economic growth would remain a mirage in any economy without a robust tax system. Besides that, taxation also influences economic agents' choices on savings and investments, production, aggregate demand, and labour supply. Many of these decisions depend not only on the tax rates but also on the mix of various fiscal instruments adopted for revenue generation (Gbato, 2017). Thus, any shock to taxes would likely upset government revenue and therefore adversely affect national productivity.

Over the years, Nigeria's low tax contribution to GDP has influenced government objectives of promoting private sector investment and accelerating economic growth (Ofurun et al., 2018). Tax collections in Nigeria are comparatively poor compared to other African countries. While other African countries have a large share of tax in their government revenues and GDP, Nigeria has held one of the lowest tax-to-GDP ratios in the world thus unable to maximise the benefits of using taxes as the cheapest, most reliable and predictable source of government revenues to finance inclusive economic growth (See Table 1.1).

Table 1.1
Tax Revenue as a percentage of GDP of Selected African Countries.

Countries	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Average**
Algeria	35.1	34.4	37.2	17.4	16.1	21.8	18.2	34.4	26.8
Botswana	23.6	23.7	27.1	25.6	25.8	24.7	20.9	22.1	24.2
Cote d'Ivoire	14.3	16.9	14.4	14.5	14.0	11.2	11.6	12.0	13.6
Kenya	20.1	21.1	22.1	25.9	16.9	16.3	16.2	15.6	19.3
Mauritius	18.0	18.0	18.6	18.4	18.5	19.0	18.1	18.6	18.4
Morocco	22.8	23.3	23.9	22.4	22.0	21.2	21.5	21.8	22.4
Nigeria	5.5	5.1	4.3	4.1	5.2	4.8	6.1	7.0	5.3
South Africa	25.0	25.2	25.6	26.0	26.5	27.3	27.1	26.9	26.2

Source: Author's Compilation from World Bank Statistical Database.

In seven African countries namely Algeria, Botswana, Cote d'Ivoire, Kenya, Mauritius, Morocco and South Africa, the tax-to-GDP ratios range from 12.0 percent to 34.4 percent in 2017 from table 1.1. However, tax revenue as a percentage of GDP in Nigeria was approximately 7 percent in the same year and consistently below the World Bank threshold of 15 percent necessary to achieve sustainable economic growth (Gaspar and Philippe, 2016). This is likely to be insufficient for the government to sustainably grow the economy without improving the ratio. During the period 2010-2017, Nigeria had an average tax as a proportion of GDP ratio of 5.3 with the corresponding figures for Algeria, Botswana, Morocco, and South Africa being 26.8, 24.2, 22.4 and 26.2 percent respectively. Although the tax-to-GDP ratio has increased marginally in recent years, more efforts are needed to raise revenues in Nigeria to support the mobilisation of domestic capital that will allow for higher spending on infrastructure, healthcare, and education. Effectively applied and properly graded taxation enables a country to be better empowered in its efforts to generate the necessary revenue to take care of its expenses, meet citizens' needs and participate

effectively in world economy (Nimenibo et al, 2018). The low tax to GDP ratio in Nigeria indicates the presence of idle fiscal space or unexploited mobilisation potential for government revenue generation (Revenue Statistics in Africa, 2016).

Nigeria's oil revenues are clearly no longer able to support its development objectives (Arowoshegbe et al., 2017). The low performance of the non-oil tax revenue has great potential of creating substantial macroeconomic instability and consequently impacting growth negatively. (Oriakhi and Iyoha, 2013). This underscores the government's determination to strengthen its fiscal framework, reduce expenditure and revive its tax system by boosting revenue from non-oil sources. This will encourage growth and job creation while maintaining debt sustainability and enhancing resilience (Lagarde, 2015). Not only is Nigerian economy unpredictable, it ranks among the world's most volatile economies (World Bank, 2014). This is true for many macroeconomic measures and does not merely represent the numerous shocks experienced over the past years in the global oil markets (Umar and Abdulhakeem, 2010). This uncertainty, when combined with poor fiscal discipline, results in a propensity to diverge from budgetary allocations and make certain decisions on government expenditure as if revenues received in one year were approximately the same as in the previous years. Compared to a constant expenditure profile, this pro-cyclical behaviour appears to increase the fiscal deficit volatility (Blanchard and Perotti, 2002).

It is equally important for policymakers in developing countries like Nigeria to be able to determine how private investment reacts to changes in government policy—not only in the design of long-term growth policies, but also in the implementation of shorter-term stabilisation programmes. Investment plays a key role in growing productivity by allowing for the use of modern manufacturing processes, technology

transfer, stimulating innovation and job creation, making it an important tool for economic growth (Babu et al, 2020). Investment also plays a vital role in making the process of growth more economically and geographically inclusive, increasing opportunities for disadvantaged people to participate and to benefit from growth. Over time, developing countries have recognised the vital role that private investment plays in fostering economic growth. Effective mobilization of private investment is therefore increasingly important for creating jobs, increasing growth rates, and reducing poverty. Given the central role of private investment in growing the economy, the trends in private investment in Nigeria have generally not been impressive (Babalola and Onikosi-Alliyu, 2020)

Nigeria has tremendous potential for investment and growth with its vast wealth of oil and gas, fertile and expansive farmland, solid minerals, and large human capital. Despite its rich resource endowments, the overall economic performance of the country over the past few decades has been decidedly unimpressive while economic growth has barely kept pace with population growth. The Nigerian economy has continued to face turbulent times with fragile GDP growth rate, poor revenue growth, increasing government expenditure and escalating debt burden. There is a pressing need to sustainably strengthen the economy, increase private sector investment, build infrastructure, reduce poverty and most of all create jobs using appropriate fiscal instruments (Rafindadi and Aliyu, 2017). Without a major structural policy reform and a revenue-driven fiscal consolidation, there would be limited resources to fund the budget and provide those infrastructural facilities essential to stimulate investment and engender growth in Nigeria.

1.2 General Overview of Fiscal Policy Instruments in Nigeria

Fiscal policy is the decisive use of taxes, government spending and borrowing to accomplish such desirable macroeconomic objectives, including economic growth (Bello et al., 2019). The intent of fiscal policy is essentially to stimulate economic and social development by pursuing a policy stance that ensures a sense of balance between taxation, expenditure and borrowing that is consistent with sustainable growth (Quashigah et al., 2016). The use of fiscal policy is very paramount in every society, most especially Less Developed Countries (LDCs) as a major tool for economic stabilization and enhancing growth. The importance of fiscal policy in impacting the dynamics of an economy was echoed by Abubakar (2016) who asserted that; in the short term, counter-cyclical fiscal expansion can help support aggregate demand and growth during cyclical downturns. Conversely, fiscal contraction can cool down an economy that is growing at an unsustainable pace and thus faces the risk of overheating. The execution of fiscal policy is basically transmitted through the budget. The budget as a fiscal policy tool could be considered as a structure that balances the changes in government revenue against expenditure over a fiscal year period (Medee and Nembee, 2011). Consequently, adjustments in the level, timing and structure of government expenditure, taxation and borrowing have a significant impact on the economy (Omitogun and Ayinla, 2007).

The mobilization of domestic resources through taxation to obtain revenue is paramount to unlocking the financial resources required by the government for investment in development, poverty reduction and deliver public services vital to the efficient functioning of a country (Micah and Alasin, 2017). Taxation remain the most effective tool of fiscal policy for mobilizing a nation's internal resources needed to

finance increasing government expenditure. It is the essence of contemporary nation that provides a viable alternative to developing countries dependency on assistance and offers fiscal support and stabilisation that is ideal for growth (Lagarde, 2015). Almost all countries in the world aspire to increase their revenue base as represented by the growth in their GDP. Hence, government of nations put in place mechanisms to increase accruable revenue from its various tax components. The tax structure should be such that it is broader enough to generate enough revenues for a government to fund many of the preconditions of a functioning business economy and several other government programmes (Charles et al., 2018). However, raising tax revenues distorts economic behaviour by adjusting the relative prices of different types of business operations. This influences how the economy allocates resources. Accordingly, raising a given sum of revenue in the least distortionary way remains a key problem in the design of tax systems. The degree, to which this initiative is successful, has potentially important welfare consequences (Maceks, 2014).

Nigeria's combination of separate direct and indirect taxes has grown over time. The term direct and indirect taxes differentiate between taxes due when income is received and when income is expended. Direct taxes are levied on personal, corporate income or property and are either deducted at source or paid directly by the individual on whom it is applied to the tax authorities (Nightingale, 2000). The main direct taxes in Nigeria payable by individuals and corporate entities are the Petroleum Profit tax (PPT), Corporate Income Tax (CIT), Personal Income Tax (PIT), Stamp duty, Education tax, Capital Gain tax and Technology Development Levy all of which are administered by the Federal Inland Revenue Service (FIRS). If the levy is on the price of goods and services, it is considered an indirect tax (Musgrave & Musgrave, 2004). Indirect taxes are consumption taxes that are levied when an item is bought by

a taxpayer and are billed to the seller as part of the item's selling price (Rosen, 2009). It is then the responsibility of the seller to pass the tax on to the tax authorities. Indirect taxes in Nigeria include Valaue Added Tax (VAT) which is administered by the Federal Inland Revenue Service, Customs (import and export duties) and Excise Duties (CED) administered by the Nigeria Customs Service.

Taxes are a significant part of government revenue and the tax-to-GDP ratio is the portion of a country's production traceable to tax proceeds, and one of the most used instruments for calculating a country's tax system's efficiency. A minimum ratio is correlated with a major improvement in growth and development according to the International Monetary Fund (IMF, 2017), The Fund assumes this threshold lies between the ranges of 15-20 percent point (Gaspar and Philippe, 2016). This supports the assertion made by Martin & Lewis (1956) who affirmed a 17-19 percent revenue to GDP ratio and by Kaldor (1964) who argued that a country's revenue- to- GDP ratio needed to be closer to 25-30 percent in order to experience fair growth. Despite the significance of these variables, Nigeria reports such low tax collections that are barely capable of adequately financing the execution of governance and meeting the needs for infrastructural development that are vital to providing a conducive environment for business and the population (Oboh et al., 2018). While decrying Nigeria's low tax efficiency, Maiye and Ogochukwu (2018) described small tax base, unregulated informal sector, tax exemptions and subsidy policies, and the tax system's lop-sidedness as contributing factors to Nigeria's low tax to GDP ratio.

For a nation of over 200 million people, not many Nigerians pay taxes (Revenue Statistics in Africa, 2016). There are many high net worth individuals, self employed, professionals and businesses who may escape full tax payment due to tax authorities' historical failure to determine their true income (Federal Inland Revenue

Service, 2017). A small tax base certainly puts immense strains on honest and compliant taxpayers. The total number of taxpayers in Nigeria in 2017 was just 14 million, according to the Federal Inland Revenue Service (FIRS, 2017). Of this number 96 percent have their taxes deducted from their wages at source under the Pay-As-You-Earn (PAYE) scheme, while only 4 percent comply with the direct assessment. This is contrary to the economic structure in which an estimated 70 million Nigerians are economically active and thus liable to pay taxes. This means that just 20 percent or one in five of Nigeria's eligible taxpayers are registered and paying taxes (FIRS, 2017). Due to its narrow tax base, the Nigerian economy has experienced poor government revenue growth for a few decades, in turn forcing the government to rely on continuous domestic and external loans to fund the budget (Egbunike et al., 2018). This scenario has adversely affected the generation of government revenue through taxes.

Furthermore, the revenue capacity of the informal sector of the economy has not been sufficiently established and exploited. The informal sector operators mainly made up of self-employed individuals, small and micro-enterprises, and other types of economic operations, do not see the need to pay tax (James and Moses, 2012). In certain instances, the revenue generated by operators in the sector is not officially captured in the state or country's tax net. The informal sector accounted for 50-65 percent of Nigeria's GDP in 2017, according to IMF (2017). This high GDP contribution does not translate into government tax revenues except businesses within the informal sector pay their taxes. Unfortunately, the tax authorities are also struggling to capture the informal businesses into their tax net using appropriate methods. Through a broader tax structure that will include the large informal sector operators in its tax net, Nigeria could significantly improve its tax base and increase

tax revenue generation (Obara and Nangih, 2017). In addition, the practice of awarding all kinds of indiscriminate tax incentives is an increasingly common yet troubling method of misappropriating government revenues in Nigeria. Nigeria has been offering many tax incentives for decades to incentivize private investment and attract foreign capital inflow. The economic and political elite have seized these tax waivers and used them specifically to garner political patronage (Besley and Persson, 2014). However, the evidence available indicates that these measures resulted in revenue losses relative to the positive economic effects of increasing investments, thereby negatively impacting the capacity of revenue generating agencies to reach their goals (Ayeni et al, 2017).

Government spending is used extensively by governments in many countries as fiscal policy tool. The efficacy of government spending does contribute to growth. A major challenge for the Nigerian economy has been its macroeconomic volatility driven largely by over reliance on volatile oil revenue (Umar and Abdulhakeem, 2010). Government revenue have been adversely affected by the sharp drop in oil prices starting in mid-2014 from a peak of USD120 per barrel to below USD 36 per barrel in 2016 (see table 1.2). Revenue volatility leads to expenditure volatility which often results in many incomplete capital projects. Unsteady revenue flows tend to reduce the quality and productivity of government expenditures in Nigeria while private investments tend to be reduced in a volatile environment. Government spending in Nigeria has been largely inefficient because of volatility in spending. Boom in capital spending may lead to less careful screening of new projects while many are based on the assumptions that high revenue will continue indefinitely (Blanchard and Perotti, 2002). When revenue falls, many projects can not be sustained and must be abandon while those that survive are either poorly executed or are well funded only through

borrowing. Overall, a procyclical expenditure pattern coupled with poor management of oil earnings resulted in low growth, persistent fiscal deficits and the accumulation of debts (Okonjo-Iweala and Osafo-Kwa ako, 2007).

Nigeria, like most other developing countries in Sub-Saharan Africa have been trapped by hasty and distress borrowing which they are often unable to service. Worse still, they need to borrow more and the inability to service existing debt obligation has often been caused by deteriorating world prices of their primary exports. Rising public debt and fiscal sustainability have been one of the major concerns of economic policy in Nigeria. Public debt is a critical tool for governments to fund public spending, particularly when it is difficult to raise taxes and reduce public expenditure. However, for countries like Nigeria with a poor economic structure, high public debt is also a critical issue, since it can create uncertainty and low economic growth. In addition, countries' high debt-to-GDP ratios are also considered a concern for investors, as they can have a negative effect on the stock market and reduce productive investment and employment in the long run (Coccia, 2017). The widening gap between tax receipts and government expenditure plan in Nigeria makes government borrowing indispensable to finance the expected level of economic growth. The sustainability of escalating public debt has become an issue (see table 1.2). Debt service payments rose to 67 percent of total revenue in 2018 resulting in weak budget execution and a major financial crisis (Akos and Istvan, 2019).

Theoretical arguments also point to a nonlinear effect of debt on growth implying that low or rational levels of debt are likely to boost economic growth whereas high levels of debt are detrimental for the stability and growth of the economy. Countries need borrowing at their early stages of growth to benefit from investment opportunities with high rates of return.

Table 1.2

Nigeria's Federally Collected Oil and Non-Oil Tax Revenues, Public Expenditure and Debts (Billions of Naira)

Years	Oil Price (USD)	Oil Revenue	Non-Oil Revenue	Recurrent Expend.	Capital Expend.	Domestic Debts	External Debts	Growth Rate
1990	23.71	71.89	26.22	36.22	24.05	84.09	298.61	11.78
1991	19.98	82.62	18.33	38.24	28.34	116.20	328.45	0.36
1992	18.44	164.08	26.38	53.03	39.76	177.96	544.26	4.63
1993	16.33	162.10	30.67	136.73	54.50	273.84	633.14	-2.04
1994	15.53	160.19	41.72	89.97	70.92	407.58	648.81	-1.82
1995	16.85	324.55	135.44	127.63	121.14	477.73	716.87	-0.07
1996	20.29	408.78	114.81	124.49	212.93	419.98	617.32	4.20
1997	18.86	416.81	166.00	158.56	269.65	501.75	595.93	2.94
1998	12.28	324.31	139.30	178.10	309.02	560.83	633.02	2.58
1999	17.44	724.42	224.77	449.66	498.03	794.81	2,577.37	0.58
2000	27.60	1,591.68	314.48	461.60	239.45	898.25	3,097.38	5.02
2001	23.12	1,707.56	903.46	579.30	438.70	1,016.97	3,176.29	5.92
2002	24.36	1,230.85	500.99	696.80	321.38	1,166.00	3,932.88	15.33
2003	28.10	2,074.28	500.82	984.30	241.69	1,329.68	4,478.33	7.35
2004	36.05	3,354.8	565.70	1,110.64	351.25	1,370.33	4,890.27	9.25
2005	50.59	4,762.40	785.10	1,321.23	519.47	1,525.91	2,695.07	6.44
2006	61.00	5,287.57	677.54	1,390.10	552.39	1,753.26	451.46	6.06
2007	69.04	4,462.91	1,264.60	1,589.27	759.28	2,169.64	438.89	6.59
2008	94.01	6,530.60	1,336.00	2,117.36	960.89	2,320.31	523.25	6.76
2009	60.86	3,191.94	1,652.65	2,127.97	1,152.80	3,228.03	590.44	8.04
2010	77.38	5,396.09	1,907.58	3,109.44	883.87	4,551.82	689.84	8.01
2011	107.46	8,878.97	2,237.88	3,314.51	918.55	5,622.84	896.85	5.31
2012	109.45	8,025.97	2,628.78	3,325.16	874.70	6,537.54	1,026.90	4.23
2013	105.87	6,809.23	2,950.56	3,214.95	1,108.39	7,118.98	1,387.33	6.67
2014	96.29	6,793.82	3,275.03	3,426.94	783.12	7,904.03	1,631.50	6.31
2015	49.49	3,830.10	3,082.41	3,831.95	818.35	8,837.00	2,111.51	2.65
2016	40.68	2,693.90	2,922.50	4,160.11	653.61	11,058.20	3,478.91	-1.62
2017	52.53	4,109.80	3,335.20	4,779.99	1,242.30	12,589.49	5,787.57	0.81
2018	69.78	5,545.80	4,006.09	5,675.20	1,682.10	12,774.40	7,759.20	1.94

Source: Author's Compilation from Central Bank of Nigeria and OPEC Statistical Database.

Borrowing helps individuals to smooth consumption, companies to smooth investments and production, and governments to smooth taxes in the face of their unpredictable revenue, sales and expenditures respectively. However, debt accumulation entails a variety of risks. As debt levels rise, the ability of borrowers to repay becomes increasingly more vulnerable to decreases in income and revenues, as well as interest rates rises (Gordon and Cosimo, 2018). In the event of a negative shock, higher debt raises the risk of default and a downturn in economic activity. As a result, high debt levels lead to real volatility, financial fragility, and lower average growth. Conversely, high debt leads investors to expect high future distortionary taxes to deter new domestic and foreign investments, which, in turn, slows down capital accumulation (Krugman, 1988). Other considerations argued that high debt levels can also limit growth by reducing total factor productivity. High debt levels in Nigeria is impeding government incentives to implement complex and expensive policy reforms, develop infrastructure and make effective use of resources. Misallocated resources and less productive investment projects may lead to slow productivity growth (Akos and Istvan, 2019).

The fiscal experience of Nigeria over the years explains the complexities of enforcing effective fiscal policy responses in an atmosphere where revenue flows are highly unpredictable. Without a substantial decrease in uncertainty, sustainable economic growth and a decline in poverty are impossible. The mono-dependence of Nigeria on oil revenues can not sustain the economy's long-run growth. A diversified Nigerian economy could benefit from increased non-oil revenues, a dramatic reduction in public debt and debt service charges, increased foreign exchange reserves and increased currency risk hedging (Alesina and Ardagna, 2013). Using the disaggregated method and the linear and nonlinear ARDL estimation techniques, this thesis examined

the effect of fiscal policy on private investment and economic growth in Nigeria. The study period covers thirty-eight years between 1980 and 2017 and encompasses economic cycles of about 64 percent of the country's life, since political independence was achieved in 1960.

1.3 Investment in Nigeria

Investment can be roughly divided into four key components: private domestic investment (private investment), public domestic investment (government investment investment), portfolio investment and Foreign Direct Investment (FDI). Private investment as described by Kumo (2006), refers to private-sector investment for profit-generating purposes. It is a fundamental guiding principle of economic operation in a market-based economy where physical as well as financial resources is typically privately-owned and production decisions are guided by profit motive. Public domestic investment involves investment in social infrastructure, real estate and tangible assets by government and public corporations (Victor and Dickson, 2013). The government needs to create an enabling environment in developing countries using enough fiscal stimulus to encourage the growth of private investment because private initiative and resources are limited.

The level of growth and development of any economy is a true indicator of the country’s capacity to invest and allocate its resources efficiently. This has encouraged several countries to focus on improving advantageous investment conditions. Public investment is required to build the infrastructure and social capital necessary for private sector investment in those sectors of the economy that gives higher returns on invested capital (Hussain and Haque, 2017). Public investment in critical sectors of the

economy should therefore act as a facilitator for the growth of the economy. Nevertheless, public investment is typically made for political purposes and consequently lacks economic rationalization (Nyoni and Bonga, 2017). Conventional wisdom suggest that private investment contributes more positively and has a greater impact on growth than public investment. Because of the comparatively lower level of corruption in the private sector, productivity in the private sector is usually higher than that of the public sector. As a result, there is currently a paradigm shift from public to private sector-led growth policies which emphasize the dominance of market forces in the economy and the reduction of the public sector in production. The new paradigm needs the public sector to redefine its role in the process of growth. The principle requires that the public sector devote their resources in areas where it supports rather than replaces private sector investment (Hermes and Lensink, 2003).

Private investment has the potential to leverage resources and make wise investment decisions that improve the efficiency and productive capacity of the economy (Babu et al, 2020). Private investment is thus a vital prerequisite for economic growth, since it enables entrepreneurs to set economic activity in motion through efficient allocation of resources to generate goods and services. Rapid and sustained growth is facilitated by a virtuous circle whereby entrepreneurship and investment lead to higher productivity, making it possible to invest larger sums in the future. During this process, jobs are created, and new innovations are implemented through international trade and investment ties (Frimpong and Marbuah, 2010). There exists a significant positive relationship between the share of private investment in overall investment and the real growth rate of the economy (Babu et al., 2020; Babalola and Onikosi-Alliyu, 2020). Such trends clearly show the effectiveness of private investment activity in motivating growth in developing countries. Yet, private

investment trends in Nigeria have largely been uninspiring. This has made successive governments in Nigeria put in place several policies to promote private sector-led growth including Economic Recovery and Structural Adjustment Programmes.

Most developing countries like Nigeria suffer from low level of domestic savings leading to a huge gap between savings and investment and a strategic way to fill this gap is through an inflow of internationally mobile capital (Ogunjimi, 2019). The vicious cycle of low investment arising from low savings result in low capital formation which has become a major problem of the Nigerian economy (Bidemi et al., 2018). When foreign investment is on tangible asset, it is referred to as Foreign Direct Investment (FDI) and called Foreign Portfolio Investment (FPI) when it is on shares, bonds, and securities. FDI is therefore, the flow of funding provided by an investor or a lender to establish or acquire a foreign company or to expand or finance an existing foreign company that the investor owns and controls (Babalola and Onikosi-Alliyu, 2020).

FPI on the other hand, consists of transfer of financial assets such as cash, stocks and bonds across international borders with a view of maximizing profit. It means the purchase of shares in a foreign country where the investing party does not seek control over the investment. It could take the form of the purchase of equity (preference share) or government debt in a foreign stock market, or loans made to a foreign company (Agu et al., 2019). FPI is a component of international capital flows comprising the movement of financial assets: such as currency, stock, or bonds across international boundaries in search of profit (Ezeanyeji and Maureen, 2019). The FDI is quite different from FPI which denotes all foreign securities investments which do not involve management or control. FDI is a capital expenditure in a business by an investor from other country for which the foreign investor has power over the company

bought. According to Babalola and Onikosi-Alliyu (2020), FDI is a type of cross-border investment connected with a resident in one economy having command or a significant degree of impact on the management of a venture that is located in another economy. Table 1.3 shows the pattern of different forms of investment in Nigeria from 1990-2017.

Table 1.3
Nigeria's Private Investment, FDI and GFCF Trend from 1990-2017

Years	Private Investment (USD millions)	Net FDI Inflow (USD Millions)	Net Foreign Portfolio Investment (USD millions)	Total Investment (% of GDP)	GFCF % of GDP
1990	N.A	587.88	197.15	12.19	53.12
1991	N.A	712.37	61.11	12.23	48.40
1992	N.A	896.84	-1884.27	13.36	43.77
1993	N.A	1,345.00	17. 78	13.15	44.48
1994	N.A	1,959.00	27.14	10.65	42.07
1995	N.A	335.84	25.58	11.60	37.21
1996	N.A	499.28	54.09	11.88	36.58
1997	N.A	469.58	20.32	13.25	38.42
1998	N.A	299.57	2.36	16.04	40.55
1999	N.A	1,005.00	11.01	17.92	38.28
2000	23, 647	1,140.00	-502.27	14.36	34.05
2001	22, 237	1,191.00	-831.77	15.14	30.04
2002	25, 534	1,874.00	-133.94	20.07	26.77
2003	29, 764	2,005.00	-182.89	17.55	28.37
2004	35,547	1,874.00	-177.82	16.55	26.06
2005	43, 974	4,983.00	750.78	15.58	24.97
2006	61,780	4,854.00	1,769.16	16.27	26.17
2007	55, 621	6,036.00	1,447.33	18.65	20.18
2008	63, 564	8,194.00	3,402.40	15.61	18.86
2009	61, 632	8,556.00	487.34	19.42	21.12
2010	61, 099	6,026.00	2,153.30	17.29	16.82
2011	64, 325	8,841.00	2,570.81	16.21	15.68
2012	65, 282	7,070.00	9,959.02	14.91	14.21
2013	72, 964	5,563.00	5,532.05	14.90	14.17
2014	85, 750	4,694.00	1,,044.96	15.80	15.08
2015	73, 333	3,064.00	-476.62	15.49	14.83
2016	59, 584	4,449.00	325.12	15.37	14.73
2017	55, 293	3,503.00	2,924.27	15.47	14.72

Source: Author's Compilation from Central Bank of Nigeria and World Development Indicators Statistical Database.

The past three decades (1990-2020) have witnessed increasing wave of financial liberalization in developing countries and the consequent substantial movement of capital across different economies. Financial liberalization led to the opening of domestic stock markets to foreign investors as a way of attaining market integration with other markets. Through liberalization, foreign portfolio flows have been encouraged with the main aim of improving market activities and access to foreign capital (Agu et al., 2019). For foreign investors, the drive has been to diversify investments, hedge against risk and to get higher returns in emerging markets given the low correlation of emerging markets with developed ones. These developments have broadened the variety of investment opportunities including foreign portfolio investment by making it an important source of investible funds to support investment not only in developed but also in developing countries. As trade flows result from individuals, firms and countries by exploiting their own comparative advantage, capitals and accumulated assets also flow to where they are likely to be most productive (Ezeanyeji and Maureen, 2019). Table 1.3 showed that in 2010 and 2011, net FPI inflow was less than half of FDI but rose rapidly from 2,570.81 USD in 2011 to 9,959.02 million USD in 2012, representing about 387 percent increase. Between 2010 and 2012 FPI showed a tremendous increase and thereafter dropped sharply between 2013 and 2014 with negative values in 2015. Net FDI inflow on the other hand, achieved its highest value of 8,841 million USD in 2011 and maintained a decreasing trend from 2011 to 2015. Similarly, net FDI inflow consistently outnumbered net FPI except for 2012.

Nigeria's 1970s oil boom, among other factors provided the basis for a public sector-led growth strategy. Public sector dominance was also overriding to give the government an increasing measure of control over its own resources. Government's

declining revenue because of the economic crisis of the 1980s coupled with the discontent with government corporations' success compelled the country to implement the Structural Adjustment Programme (SAP) in 1986 (Nwakoby and Bernard, 2016). After acknowledging the need for a change of approach, the country has focused on private sector-led growth. SAP and other policies have contributed to the much-needed private investments. The proposals to privatise and commercialise public enterprises have now become a major policy objective to benefit the private sector (Osinubi and Amaghionyeodiwe, 2010). These policies have played an important role to date in re-defining the Nigerian economy.

A country's fiscal policy design and execution may either crowd-out or crowd-in the growth of private investment. In the economy, an expansionary fiscal policy will crowd-out private investment. Government spending on infrastructure such as transportation and communications networks, electricity supply and other energy sources serve as critical ingredients for private investment growth (Barro and Sala-i-Martin, 1992). On the other hand, government spending will discourage private investment if it is funded by tax hikes or borrowing. Fiscal deficit in Nigeria is financed through domestic or external borrowing which pushes up interest rates in the financial market and thus result in high cost of borrowing, thereby crowding-out private investment. Borrowing to fund government spending retards the growth of private investment as investors who buy these debt instruments are left with less capital for further investment in private quarters (Babalola and Onikosi-Alliyu, 2020). As both the public and private sectors compete in the capital market for funds, interest rates rise which is a deterrent to private investors. Moreover, deficit-financed public spending means that higher taxes will be imposed in the future to liquidate the debt that acts as a discouragement to private investors (Blanchard and Perotti, 2002).

In deciding private investment, the degree of taxation is also very cardinal. Higher tax rates ensure ample profits and prevent budget deficits that either attract or fend off investors on their own (Victor and Dickson, 2013). Tax incentives may be used to stimulate private investment in certain sectors of the economy. However, if taxes are not correctly managed, it can serve as a disincentive to investment rather than help boost economic growth revenues. Heavy tax burden decreases disposable income of individuals as well as corporate bodies, reduce savings and then reduce the aggregate demand of the economy which could discourage investment and make employers of labour lay off workers (Babalola and Onikosi-Alliyu, 2020). Furthermore, taxes have a negative effect on production cost and on profitability, thereby reducing after-tax returns and preventing private investment. A key challenge for Nigeria has therefore been to find the right balance between a business-friendly and investment-friendly tax regime and one that can exploit ample revenue for public service delivery to boost the economy's foreign competitiveness (Adejare and Akande, 2017).

Economic growth depends on the capacity of a country to invest, make efficient and productive use of its resources. Private investment has long been recognised as one of the determinants of growth (Kengdo et al., 2020). The role of private investment is significant both in contributing to the growth of GDP and in its capacity to effectively allocate and use resources (Barro and Sala-i-Martin, 1992). Herandez-Cata (2000) and Babu et al., (2020) therefore argued that Sub-Saharan African countries desirous of sustainable growth and poverty reduction should aim and maintain a level of private investment of at least 25 percent of GDP. In writing on the experiences of Asian countries, Bage (2003) found that investment rates of between 20 and 25 percent could produce growth rates of between 7 and 8 percent. Developing countries

including Nigeria, need to maintain private investment at a substantial percentage of GDP to generate and sustain economic growth (Babu et al., 2020). While China has an average private investment as a percentage of GDP ratio of 46 percent between 1993 and 2014, the average for Nigeria was less than 15 percent for the same period (Nigerian Investment Promotion Commission, 2018). This percentage is lower than what is obtainable in most Sub-Saharan African economies and which is needed to achieve higher economic growth rates (World Bank, 2016). Despite the significant increase in government fiscal operations in recent years designed to achieve increased private sector led growth, the stylized fact in Nigeria showed that the rate of growth of private investment has been unimpressive and continued to stagnate (Duruechi and Ojiegbe, 2015). It is upon this basis that this study was partly designed to interrogate the individual effects of disaggregated components of fiscal policy instruments on private investment in Nigeria using data spanning the period 1980-2017.

1.4 Economic Growth in Nigeria

For constitutionally elected governments, material prosperity and high standard of living are universal priorities. However, the exact way of achieving these objectives has been the subject of considerable theoretical debates and polemics. Like many other countries of the world, the major policy objective of Nigeria is to promote a process of sustainable growth that could enhance the welfare of the citizens (Ajide, 2014). Nigeria's economic ambitions have been to shift the patterns of production and consumption, diversify the economic basis and reduce oil reliance, in order to drive the economy towards sustainable, integrated and non-inflationary growth. While rapid production growth is important, as measured by the real GDP, it is even more necessary to transform various sectors of the economy. The economic structure is

expected to change as growth progresses. This is consistent with most developing countries' expectations for growth. (Sanusi, 2010).

At independence in 1960, agriculture was the mainstay of the Nigerian economy. Exports of agricultural products and solid mineral accounted for the bulk of government revenue. The country's four regions (North, East, West, and Midwest) were giants in the export of agricultural products. The North was legendary for groundnuts, cotton, hides and skin production, the East was illustrious for palm produce and coal production, the West was renowned for its cocoa, and the Midwest for its rubber and timber. The revenues were used by the individual regions to develop their territories, while the revenue balance was remitted to the federal government. Unfortunately, at the dwindling altar of crude oil, this rich source of government revenue in the Nigerian regions promising limitless economic growth was sacrificed. In the early 1970s, several structural changes occurred in the country's revenue profile, in which indirect taxes gave way to direct taxes with the advent of the country's first oil boom in 1972/1973. Since then, the bulk of government revenue and foreign exchange earner has been oil (Saibu and Apanisile, 2013).

Nigeria is richly endowed with human and natural resources and is in terms of GDP and population, Africa's largest economy. Until recently, the country has benefited from huge oil windfall linked to rising oil prices over the past few decades. Crude oil prices increased from a mere $18 per barrel in 1999 to a record level of $110 per barrel in 2012 (see Table 1.2). Since 2014, however, crude oil prices had been on the declined, with significant consequences for fiscal policy management in Nigeria (Akinkumi, 2017). The decades of rising oil prices prompted the Nigerian government to implement a fiscal rule focused on oil prices, establishing a stabilisation fund (Excess Crude Account, ECA) for excess revenue from crude oil sales. The proceeds