Fiscal Policy and the Manufacturing Sector Performance: Effect on Economic Growth

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Abstract

This study examines the impact of the labour market and the manufacturing sector on Nigeria's economic growth from 1993 to 2023. Employing the Solow-Swan growth model and Dynamic Ordinary Least Square (DOLS) analysis, the study investigates the relationship between economic growth and key variables such as labour market participation, manufacturing output, gross fixed capital formation, inflation, and interest rates. The findings reveal that the labour market, manufacturing output, and gross fixed capital formation positively and significantly influence Nigeria's real GDP, indicating their pivotal roles in driving economic growth. Conversely, inflation and interest rates exhibit a negative but significant effect on economic growth. The study highlights the need for targeted policies to enhance workforce skills, increase credit accessibility for small and medium-sized enterprises, and foster public-private sector collaborations to boost manufacturing and economic growth. These insights provide valuable recommendations for policymakers aiming to achieve sustainable economic development in Nigeria.

Key words: Fiscal policy, manufacturing sector, labour market, economic growth.

1. Introduction

The manufacturing sector is an important catalyst for the real growth and development of economies and a platform for job opportunities, and poor performance in this sector is of a great danger to the growth of any economy. Manufacturing sector generates income, innovative ideas, infrastructural advancement and improvement, creation of goods for export, and also contributes to a diversified and stable economy. The manufacturing sector creates means through which goods and services are produced, enable job opportunities and ensure that economic agents earn a good pay (Olufemi, 2021). Manufacturing begins right from when the raw materials are extracted up to the point of conversion to finished products. In our world today, industrialization is being introduced to better enhance the performance, productivity and efficiency of the manufacturing sector. Fiscal policy is generally known as the use of spending, borrowing and tax as fiscal tools by the government to manage and control the economy. Fiscal policy as defined by Aiyedogbon *et al*. (2023) is a key stabilization tool used to undertake measures that controls and regulates the amount, volume, availability, and also how money is channeled within an economy, to achieve the set macroeconomic targets and to constrict the undesired in the economy. Okorie (2017) expatiated the Nigeria's fiscal policy aims which are to; alleviate poverty, encourage economic growth, enhance gross domestic product growth, reduce inflation, improve balance of payment disequilibrium and exchange rate. According to Idris and Bakar (2017), fiscal policy is a macroeconomic management tool that is essential for any economy, because this policy affects the income after tax of individuals and organizations. Hence, there is need for these policies to align with the rising demands and needs of the economy, to enable its efficiency and sufficiency. Various factors have hindered the proper implementation of fiscal policy in Nigeria, which continues to affect the macroeconomic objectives likewise the manufacturing sector activities (Alugbuo *et al.,* 2023).

Tax is the major fiscal tool used in Nigeria to attain the set macroeconomic targets, control the activities of the financial sector and ascertain the needed investment for growth and development. This tax system greatly affects the development of manufacturing sector, in the case of Nigeria, tax is a source of revenue to the government, hence the tax rate is increased to acquire as much revenue possible by all means (Alugbuo *et al.,* 2023). Increase in companies tax makes it difficult for industries to raise sufficient fund as capital in the capital market, also internal source of fund is taxed. Hence, companies resort to borrowing which sometimes if too much hinders the business ability to create investments. A country's interest rate can be affected and be forced to increase by excessive government borrowing and debt, just like in the case of Nigeria, impacting investment and individuals spending patterns (Emily, 2024).

The manufacturing sector experiences poor performance as a result of lack of or insufficient availability of credit facilities and infrastructural facilities, insufficient raw materials, etc., these factors force industries to take actions that retrench workers or lead to the winding up of industries. For instance, the close down of the textile industries in Nigeria, these actions are one major cause for the declined contribution of manufacturing sector to the total gross domestic product

(Aiyedogbon *et al.,* 2023). The poor performance of manufacturing sector in Nigeria is as a result of issues in raw materials, excessive importation of finished products, corruption and ineffective policies, poor budget implementation, absence of integrated macroeconomic plans and harmonization, improper organization of fiscal policy, mismanagement and unaccountability of public funds (Okafor, 2012; Ajudua & Imosis, 2018).

Despite various policies and reforms adopted by developing countries to achieve industrialization, failure still persists. For example, the import-substitution industrialization strategy between 1962 and 1968 (Ishola, 2012), this strategy failed because it still depended on import of raw materials, inefficient and ineffective energy supply, poor technologies and scarce expertise. Also, the overdependence on the oil sector still remain evident in the continual decline experienced in the manufacturing sector, causing shocks in economic development. Despite the fact that Nigeria economy is richly blessed with natural resources, the World Bank statistics depicts that her citizens suffer extreme poverty and find it difficult to earn $2 daily.

Objectives of the study

The broad objective of this study is to examine the effect of fiscal policy and manufacturing sector performance on economic growth in Nigeria between 1993 and 2021. While, the specific objectives are to: examine how tax as a fiscal tool affects manufacturing sector performance in Nigeria; examine how government spending as a fiscal tool aids manufacturing sector performance in Nigeria.

2. A Review of Conceptual and Empirical Literature
2.1. Conceptual Review
Fiscal Policy. This is the use of the instruments of tax and government expenditure to control the activities that occur in an economy. The main target is to foster enhanced growth and drastically reduce poverty levels in the country. It is referred to as the government budget policy for controlling the tax and expenditure levels within the economy. It is deliberate action of the government to achieve macroeconomic objectives of the nation (Muhamad & Henry, 2020). Ighoroje and Akpokerere (2021) expatiated that fiscal policy comprises the use of taxation, government spending and public debt to affect the rate and growth of aggregate demand, creation of job opportunities and output. Hence, the policy involves all the means through which government generate revenues, incur expenses and make repayments in the quest to regulate the economy. Fiscal policy has four major components which are; taxation, expenditure, investment & disinvestment ad debt/ surplus management. According to Eze *et al.* (2019), government expenditures are expenses incurred for government maintenance, creation of public goods and services and services to promote or enhance economic growth and improve societal welfare. Public expenditure categories include; defense (security), health, education, administration, external affairs, etc. Investment in capital expenditure helps to improve real sector growth as a result of creation of infrastructural and social facilities for the people. Taxation is the method by which government generate revenue through its agencies from its citizens (individuals and businesses), this process influences disposable income levels and consumer demand patterns (Abiola, 2024). According to Edame and Okoi (2014), taxes are financial obligation made by individuals or

corporate entities to compulsorily contribute to the revenue of the country, which will be used to offset government spending.

Manufacturing Sector According to Ogundipe (2022), manufacturing is a detailed process involving tools utilization, machinery, human labour and chemical processes to convert raw materials into finished goods, intermediate goods or semi-finished goods. This sector is a complex one that also contains the utilization of advanced technology, complex equipment and machinery to manufacture goods and services that improve human welfare and quality of life (Abiola, 2024). Productivity plays a major role in the economic prosperity of a nation, generation of huge income and creation of jobs. Manufacturing sector plays a very vital role in determining the extent to which any nation is developed especially in the case of underdeveloped and developing countries. Solow (1956), highlights some causes of growth in a nation which are diminishing marginal productivity of capital, exogenous technological progress, rate of substitution of capital for labor and vice versa, constant returns to scale. These factors together with savings and investment contribute highly to the immediate growth in any economy.

2.2. Empirical Review

Alugbuo *et al.* (2023) examined fiscal policy, automatic stabilizers and manufacturing sector performance in Nigeria between 1981 and 2022. Secondary data sourced from World Development Indicators (WDI) was used, and ARDL method of estimation was applied. Findings revealed that aggregate government spending is inversely related to manufacturing sector output in the short-run, and in the long-run, it is said to be positively related. Revenue generated from tax also had an inverse relationship with manufacturing sector output in the examined period, which contributed immensely to manufacturing sector performance in past periods. Gross capital formation had an insignificant positive nexus with manufacturing sector output in the examined period.

Aiyedogbon *et al.* (2023) assessed the effect of fiscal policy on manufacturing sector output in Nigeria during the periods of 1986-2021. Secondary time series data was employed, using the fully modified ordinary least square method for analysis. It was revealed that fiscal policy implementation increases the manufacturing sector output. Kim *et al.* (2021) investigated fiscal policy and economic growth in China between 1985 and 2015. The study employed secondary source of data, using impulse response to show the relationship between the variables. Evidence revealed that local spending growth has more impact on output growth compared to central expenditures growth. Also, output growth response to predicted changes in tax was restrained by liquidity constraints. At the birth of market-oriented reform, public investment growth in manufacturing sector contributed the most to output growth, addition of research and development has also made for increased growth. Lastly, long-term debt significantly influences the fiscal system, emphasis on the revenue aspect. Emily (2024) examined the impact of fiscal policy indicators on the non-manufacturing industrial sector in Nigeria in periods 1987 to 2022. Secondary data was sourced from CBN statistical bulletin, and the study adopted the auto-regressive distributed lag (ARDL) technique for its analysis. The result of the findings revealed that government recurrent expenditure and oil taxation have a significant positive effect on non-manufacturing industrial sector in Nigeria, but non-oil taxation has a positive effect on manufacturing industrial output, which still remained insignificant in boosting industrial output.

Government capital expenditure, public external and domestic debts negatively affected manufacturing industrial sector in Nigeria. Tendengu *et al*. (2022) examined fiscal policy and economic growth in South Africa between 1988-2018. This study made use of secondary data, then resorted to the use of auto-regressive distributed lag (ARDL) model to process the data. Empirical findings showed positive nexus between fiscal policy tools (taxation and expenditure) and economic growth.

Furthermore, Ighoroje and Akpokerere (2021) studied fiscal policy and industrial sector output in Nigeria within the frame of 1987 to 2019. The study employed multiple regression method using the Johansson cointegration error correctio model as the base. The result revealed that fiscal policy has both long and short run effect on industry output, also government spending and budget deficit have significant positive impact on industry output while taxation has an insignificant impact. Ajudua and Imoisi (2018) assessed the nexus between fiscal policy and manufacturing sector in Nigeria between 1986 and 2016. Time series data were used and error correction model estimation technique was employed. The study's findings revealed that government spending have a significant positive relationship with manufacturing sectoral output while government revenue was insignificant positive with manufacturing sectoral output. Abiola (2024) investigated the impact of fiscal policy on manufacturing sector growth performance in Nigeria from 1981 to 2022. Secondary time series data was sourced and regression analysis was used to determine the relationship. It was discovered that manufacturing sector performance and government capital expenditure are positively correlated. Uffie and Aghanenu (2019) examined the effect between fiscal policy and manufacturing sector output in Nigeria from 1981 to 2016. The auto-regressive distributed lag (ARDL) and bounds test approach were used to process the time series data. Results showed long run equilibrium relationship among the variables. Also, government spending boosts manufacturing output especially when there is increase in capital expenditure while company income tax reduces output, this could be attributed to multiple taxes. Effiong *et al*. (2024) assessed fiscal policy, interest rate and manufacturing sector performance in Nigeria between 1981 and 2021. The study obtained time series data ad made use of the auto-regressive distributed lag (ARDL) approach. Findings revealed that in the short run, government expenditure showed a significant negative effect on manufacturing sector performance, value added tax had a significant positive effect while interest rate had a significant positive effect. In the long run, government expenditure had an insignificant negative effect on manufacturing sector performance, value added tax and interest rate had a significant positive effect. Onye *et al.* (2023) assessed the impact of manufacturing sector performance and Nigeria's economic growth between 1986 and 2020. Secondary source of data was gathered and the auto-regressive distributed lag (ARDL) and error correction model (ECM) methodologies were used. It was revealed that manufacturing sector output and economic growth have a significant short run relationship. Also, manufacturing sector performance has a significant positive impact on Nigeria's economic growth.

Afolabi and Laseinde (2019) examined manufacturing sector performance and economic growth in Nigeria over the period of 1981 to 2016. The study adopted secondary data and made use of auto-regressive distributed lag (ARDL) and the granger causality techniques. The findings reveal that manufacturing capacity utilization, money supply and manufacturing output positively effects economic growth, while gross investment expenditure had negatively effects on economic growth.

Moyo and Jeke (2019) investigated manufacturing sector and economic growth as a panel study of selected African countries between 1990 and 2017. The study employed system-general method of moment (GMM). The result indicated that manufacturing output positively effects economic growth in African countries.

3. Methodology

3.1. Theoretical Framework

This growth model was developed by John Maynard Keynes (1936) in his book "The General Theory of Employment, Interest and Money". The Keynesian growth model establishes the rationale for government intervention in the economy to enable stability and stimulation, especially during periods of downturn. For instance, during the Great Depression (1929 – 1939), this model provided a way out in the United States. Aggregate demand is the drive of growth in this model, and it comprises of consumption, government spending, investment, imports and exports. As aggregate demand increases, business activities tend to respond positively which then brings about increase in employment and income, the later leads to increase in consumption further increasing demand. The role of government during periods of downturn is to make use of the fiscal tools by reducing tax or increasing government expenditure, and vice versa during periods of boom to revive the economy. Increase in government expenditure must be backed by corresponding economic activities, for it to deliver the expected result and not cause more problems like inflation. Through this, aggregate demand is boosted and growth increases. Also, government spending has a multiplier effect, that is., the initial increase in government spending can produce a greater overall increase in economic output. This effect necessitates the need for government spending to boost economic activities even in periods that private sectors suffers insufficiency, this will continue to promote growth. Public expenditure increases money supply in the economy, creating avenue for more investment, and investments facilitate the development process of a nation as well as industrialization (Emily, 2024). This model also includes other factors that influences economic growth and development such as improvements in productivity, technological progress, labor force inclusion rates, etc.

3.2. Model Specification

$$RGDP_t = f\,(TAX_t,\ EXP_t,\ INF_t,\ MVA_t,\ LAB_t,\ GCF_t)\dots (1)$$

Explicitly, $RGDP_t = \beta_0 + \beta_1 TAX_t + \beta_2 EXP_t + \beta_3 INF_t + \beta_4 MVA_t + \beta_5 LAB_t + \beta_6 GCF_t + \mu_{t\dots}$ (2)

In its logged form,

$$LRGDP_t = \beta_0 + \beta_1 LTAX_t + \beta_2 LEXP_t + \beta_3 LINF_t + \beta_4 LMVA_t + \beta_5 LLAB_t + \beta_6 LGCF_t + \mu_{t\dots}$$ (2)

Where RGDP, real gross domestic product is used to measure economic growth; Fiscal policy is measured with tax (TAX), and expenditure (EXP); Manufacturing sector is measured with manufacturing value added (MVA); LAB, labour, INF, inflation and GCF, gross capital formation

are the control variables; t = time; μ_t = error term; β_0 = intercept; $\beta_{i\,=}$ estimated coefficients of variables (where i = 1, 2,3,4,5,6)

3.3. Data
Table 1. Measurement and Sources of Data

Variables	Measurement	Source(s) of Data
RGDP	Used to measure economic growth.	CBN
EXP	A fiscal tool used to capture an aspect of fiscal policy (measured in millions of dollar).	Countryeconomy.com
TAX	A fiscal tool used to capture the other aspect of fiscal policy. Company Income Tax (measured in billions of naira).	FIRS
MVA	Used to measure manufacturing sector performance (in percentage).	WDI
INF	Inflation rate, consumer index (% annual).	WDI
LAB	Labour force (% of total population).	WDI
GCF	Gross fixed capital formation (% of GDP).	WDI

Note; In estimating the variables, all variables were logged because of the difference in measurement units.

Table 2. Correlation Analysis

	TAX	EXP	GCF	INF	LAB	MVA
TAX	1					
EXP	0.56	1				
GCF	-0.82	-0.51	1			
INF	-0.48	0.04	0.42	1		
LAB	-0.58	-0.22	0.15	0.13	1	
MVA	-0.78	-0.54	0.89	0.50	-0.01	1

Before estimating the variables using various techniques, correlation analysis was carried out to ensure that the independent variables are independent of each other. This is to avoid multicollinearity.

Table 3. Descriptive Statistics

	RGDP	EXP	GCF	INF	LAB	MVA	TAX
Mean	10.64	10.21	3.23	2.63	4.09	2.44	5.41
Median	10.69	10.58	3.30	2.53	4.10	2.39	5.81
Maximum	11.20	11.24	3.80	4.29	4.10	3.04	7.47
Minimum	9.99	3.24	2.70	1.68	4.07	1.88	2.26
Std. Dev.	0.46	1.45	0.36	0.63	0.01	0.34	1.66

Source: Authors' Computation, 2024

Descriptive statistics was also conducted to ensure that all variables to be used are normally distributed and reliable.

Table 4. Unit Root Analysis

Variables	Phillips Perron (PP)		Augmented Dickey-Fuller (ADF)	
	Constant	Remarks	Constant	Remarks
RGDP	-2.92	I (1)	-2.93	I (1)
TAX	-3.40	I (0)	-5.20	I (1)
EXP	-4.40	I (0)	-4.27	I (0)
MVA	-3.41	I (1)	-3.28	I (1)
LAB	-4.06	I (1)	-4.08	I (1)
INF	-3.23	I (0)	-3.51	I (0)
GCF	-3.37	I (1)	-3.37	I (1)

Note: the table was compiled using 5% level of significance
Source: Authors' Computation, 2024
Unit root analysis to ascertain the stationary levels of each variable was also conducted, using both the Phillips Perron (PP) and Augmented Dickey-Fuller (ADF). In table 3, I (0) remark represents stationary at level while I (1) remark is for stationary at first difference order. The only unit root segment considered in this study is that of constant. This explanation is represented in table 3 below;The unit root results combine I (0) and I (1) stationarity hence, this study made use of Fully Modified Ordinary Least Square (FMOLS) method for further analysis. The further analysis was done in correspondence with the research objectives and hypotheses.

4. Empirical Analysis and Discussion of Result.

4.1 Estimated FMOLS model

Table 5. Dependent Variable; RGDP

Variables	Coefficients	Standard Error	T-Statistic	Probability
EXP	-0.01	0.01	-0.92	0.37
GCF	-0.13	0.05	-2.56	0.02
INF	0.08	0.02	5.09	0.00
LAB	-3.11	2.44	-1.28	0.22
MVA	-0.02	0.09	-0.27	0.79
TAX	0.26	0.02	11.96	0.00
Adjusted R^2	0.92			

Source: Authors' Computation, 2024
The broad objective was to examine the effect of fiscal policy and manufacturing sector performance on economic growth in Nigeria. From Table 5, expenditure causes decrease in economic growth and it has an insignificant effect on economic growth. Tax leads to a significant increase in economic growth, while manufacturing sector performance also reduces the rate of growth in the economy, and is shown to be insignificant. This finding is in line with Tendengu *et al.* (2022) for tax, and negates the results from Onye *et al.* (2023). Gross capital formation has

anegative significant effect, inflation has a positive significant effect, and labour has a negative significant effect on economic growth.

Estimated FMOLS model

Table 6; Dependent Variable; MVA

Variables	Coefficients	Standard Error	T-Statistic	Probability
GCF	0.23	0.12	1.98	0.06
INF	0.05	0.03	1.55	0.14
LAB	-22.48	3.48	-6.46	0.00
TAX	-0.18	0.03	-5.62	0.00
Adjusted R^2	0.92			

Source: Authors' Computation, 2024

From table 6, where the effect of taxation on manufacturing sector performance was examined, it revealed that taxation has a negative significant impact on manufacturing sector performance in Nigeria. Labour also has a negative significant impact while, gross capital formation and inflation have positive insignificant impact on economic growth. This result aligns with that of Alugbo *et al.* (2023), Emily (2024) and Uffie and Aghanenu (2019) as regards the negative impact of taxation. The findings also negate that of Aiyedogbon *et al.* (2023) and Ighoroje and Akpokerere (2021).

Estimated FMOLS model

Table 7; Dependent Variable; MVA

Variables	Coefficients	Standard Error	T-Statistic	Probability
EXP	-0.062939	0.03	-2.25	0.03
GCF	0.696349	0.12	5.64	0.00
INF	0.159186	0.06	2.33	0.03
LAB	-7.971473	3.99	-2.00	0.06
Adjusted R^2	0.82			

Source: Authors' Computation, 2024

From table 7, where the effect of government expenditure on manufacturing sector performance was examined, it revealed that government expenditure has a negative significant impact on manufacturing sector performance in Nigeria. Labour also has a negative significant impact while, gross capital formation and inflation have a positive significant impact on economic growth. This result is in line with the study of Alugbo et al. (2023), but differs from that of Ighoroje and Akpokerere (2021), Ajudua and Imoisi (2018) and Uffie and Aghanenu (2019).

4.2. Discussion of Findings The findings from the broad objective depicts what really happens in our country today, expenditure is incurred for non-productive reasons and not to boost economic activities. The manufacturing sector is a crucial aspect of the economy, from the analysis it is not performing well, hence the reduction in Nigeria's growth rate. The effect of taxation on

manufacturing sector performance shows that the more companies are taxed the less residual income they have to plough back into their business or start up new businesses and invest more. The effect of government expenditure on manufacturing sector performance result could be attributed to government mismanaging the allocated funds to create enabling environment for businesses, providing infrastructural facilities, unavailability of grants and aids to help businesses thrive. Each analysis also indicates that they all are of good fit.

5. Recommendation

Manufacturing sector is a catalyst for growth and development hence, government should ensure to engage in initiatives and activities that boosts the productivity of this sector. Government expenditure should be channeled towards boosting economic activities, spending should be more of capital than recurrent in order to keep generating returns (revenue) and enhancing economic growth. The tax policy in the economy should be such that business activities are not too contracted to expand or venture into new and different other investments.

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