A DISAGGREGATED ANALYSIS OF THE IMPACT OF GOVERNMENT EXPENDITURE ON ECONOMIC GROWTH: EVIDENCE FROM NIGERIA

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ABSTRACT: This paper examines the impact of government expenditure on the economic growth of Nigeria using a disaggregated data set over a seventeen years period from 1999 to 2016. Using ex post facto research method in a multivariate regression methodology, the paper sheds light on how government expenditure influences economic growth in Nigeria. Contrary to a priori expectation the result shows that only expenditure on health has a significant and positive effect on economic growth while the other disaggregated composites show largely positive but insignificant effect on economic growth in Nigeria within the study period.

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1. Introduction

The deplorable basic infrastructure in Nigeria is a basic feature of the Nigerian State in spite of considerable budgetary allocation over the years. Governments’ investment in infrastructure is certainly connected to the perceived nexus between infrastructure and economic growth. It has been argued that economic growth brings about a better standard of living of the people and this is brought about by improvement in infrastructure, health, housing, education and improvement in agricultural productivity. Sustainable growth and development are often enhanced by general growth in the economy, and economic growth is enhanced by the expansion of infrastructure, the improvement of education and health services, improved security and food security. These sectors are very important in stimulating the economy by addressing the nation’s foremost needs, and thereby bring about sustainable development.

Despite the huge amount of public expenditures which have been recorded in Nigeria, there is still an insignificant level of development. Public expenditure on all the important sectors
is expected to lead to economic growth in the sense that human capital is essential to growth. A healthy population is the wealth of a nation. Healthy labour force enhances productivity and promotes economic growth. Expenditures on infrastructure such as transportation and communication will bring about reduction in production costs, which will surely increase private sector investment and profitability of firms and thereby fostering economic growth. Good health promotes hard work and productivity. Capital in the form of national defense is a necessity for safeguarding and protecting the nation from outside aggression, while agriculture in the form of food production is a necessity for human existence.

The relationship between public expenditure and economic growth has continued to generate series of controversies among scholars in economic literature. While some authors believe that the impact of government expenditure on economic growth is negative or non-significant others consider that the impact is positive and significant (Akpan, 2005).

The recent revival of interest in growth theory has also revived interest among researchers in verifying and understanding the linkages between fiscal policies and economic growth. Over the past decade and a half, a substantial volume of empirical research has been directed towards identifying the elements of public expenditure that bear significant association with economic growth. This empirical literature varies in terms of data sets, econometric techniques, and often produces conflicting results. Explanations offered to account for these varied and conflicting results can broadly be divided into two categories. According to the first, it is the differences in the set of conditioning variables and initial conditions across studies that are responsible for the lack of consensus in the results. In contrast, the second category consists of a handful of studies that suggest this variation in the results, in part at least, reflects the wide spread tendency among researchers to ignore the implications of the government budget constraint for their regressions. In particular, the latter view emphasizes the need to consider both the sources and the uses of funds simultaneously for a meaningful evaluation of the effects of taxes or expenditures on economic growth (Adebiyi, 2003).

Expenditure on investment and productive activities is expected to contribute positively to economic growth, while government consumption spending is expected to be growth retarding. Government controls the economy through the use of public expenditure. This instrument of government control promotes economic growth in the sense that public investment contribute to capital accumulation. Other importance of government expenditure includes the provision of those facilities that are not covered by the market economy such as health economic growth. That is, human capital promotes high benefit associated with economic growth, but the financial source for public expenditure which is the taxation reduces the benefits of the taxpayers and as such reduces the benefits associated with economic growth. The beauty of public expenditure in promoting economic growth lies with the way it is being spent. In empirical literature, while some authors believed that there is no impact of public expenditures on economic growth others believed that the impact is negative while some believed that the relationship is insignificant. Economic growth is an essential ingredient for sustainable development (Barro, 1990).

In addition to producing conflicting views, the existing literature displays a disturbing trend. Most of the conclusions drawn recently regarding the growth effects of public spending are
based either on the experiences of a set of developed countries or on the basis of large samples consisting of a mixture of developed and developing countries. Accordingly, there remains little by way of understanding the process by which public expenditure policies shape the prospect of economic growth for developing countries.

This trend has continued despite the long standing view among development experts that there exists not only a significant difference in the composition of public expenditure between the developed and developing countries, but the difference is also profound in the way in which public expenditures shape the outcome in these two set of countries. Despite their commendable objective, these studies, however, share one of the aforementioned weaknesses that are pervasive in the existing literature (Saad and Kamel, 2009).

Hence, this paper uses the disaggregated approach to examine the impact of public expenditure on economic growth through the sectoral allocations in health, agriculture, education and communication and transportation. Subsequently, the rest of the paper is organized as follows. In section two, existing empirical evidence are examined. Section three, contains the methodology, presentation and analysis of data while section contains the conclusion.

2. Literature review

Several empirical studies have supported the assertion of the existence of a relationship between fiscal policy and economic growth in several economies of the world following the Keynesian philosophy that pulled depressed economies out of depression during the great depression era. Empirical studies in some developing economies tell the same story. For instance, Ekpo (1994) found a positive correlation between public investment and economic growth as the former crowded in private investment.

In the same vein, from the study of a panel of 40 African countries, Aregbeyen (2007) established a positive and significant correlation between government capital and public investment and economic growth, while he found that current and consumption expenditures were negatively associated with it. Other studies also confirm either a negative or a positive correlation/relationship between fiscal policy (with government expenditure, public investment or related variables used as proxies) and economic growth.

Theoretically, government expenditure is positively correlated with GDP (Onoh, 2007). The underlying assumptions however are that: (1) the economy is operating below the full-equilibrium level; and (2) the expenditure is channeled to productive investments to increase output of goods and services, and to increase national income. As a result, increase (decrease) in government expenditure may lead to increase (decrease) in GDP. However, government expenditure should not be increased indefinitely to avoid inflationary pressures from setting in. The increase should continue only to the point of achieving full-employment level. Bose, Haque, & Osborn (2003) found that government capital expenditures in GDP is positively and significantly correlated with economic growth but that the growth effect of current expenditure is insignificant.

This theoretical postulation has been empirically asserted by some studies. Ram (1986), using cross country regressions, found that while growth in general is positively correlated
with rate of change in total public expenditure, it is negatively correlated with the level of such expenditure. Again, Ram (1986) and Grossman (1988) reported positive relationships between government fiscal deficit and economic growth. Kouassy & Bohoum (1994) found that public investment in Cote d’Ivoire had a net crowding-in effect on the private sector and a positive impact on economic growth.

Lin & Liu (2000), working with data from the Chinese economy, showed that fiscal decentralization significantly contributed to economic growth rate mainly through efficient resources allocation rather than by inducing additional investment. This agrees with the hypothesis that fiscal decentralization can increase economic efficiency.

Results of the 1996/97 National Consumer Survey showed that about 56 percent of Nigerians live below the poverty line. In 1985 about 43 percent were below the figure at 34.1 percent at 1985 prices. In 1992, 46.4 million Nigerians were said to be living in absolute poverty, out of which 80.2% or 37.7 million are in the rural areas. The marginalization of the rural areas through urban-biased development policies is largely responsible for the high poverty incidence in the rural areas (Obi, 2007). These statistics indicate a worsening poverty situation in the country and a cause for concern (Okunmadewa, 1999).

Fosu (2009) explored the extent to which inequality influences the impact of growth on poverty reduction, based on a global sample of 1977-2004 unbalanced panel data for SSA and non-SSA countries. Several models are estimated, with the increasing headcount, gap and squared gap poverty ratios as respective dependent variables, and the increasing Gini and Purchase Power Parity (PPP)-adjusted incomes as explanatory variables.

Budget policy, as a broad fiscal variable in terms of the size of expenditure relative to revenue, has occupied the center stage in recent policy deliberations in many developing and transition economies. Fiscal dimensions, such as high unemployment, inadequate national savings, excessive budget deficits and public debt burdens, have intensified in many developing countries over the years. Hence, issues relating to the appropriate scope, nature and conduct of budget policy, in the context of both fostering growth and alleviating poverty (while ensuring macroeconomic stability) have naturally come to the fore in policy debates.

Of course, the relevance of considering the growth effects of fiscal policy must be predicated on the basic proposition that policy matters for long-run growth. However, a clear and direct link between budget policy and growth has traditionally been associated with tax policy. One link is built on the idea that taxes are non-neutral (in terms of private economic agents’ allocative decisions). Hence, distortions are introduced into the economy. A second link is via the impact of taxation on factor accumulation, particularly capital. It relates to the excess burden of taxation in a dynamic sense. Another channel usually suggested in the literature is the provision of tax incentives for promoting investment and research and development activities.

The basic idea is that the structure of taxation could have important implications for growth. This consideration is actually not limited to simply the area of capital income taxation, or even to income taxation in general; it has, in fact, broad significance for the overall structure of the entire tax system. It should be noted that the empirical evidence of the impact of various aspects of tax policy on growth has so far been mixed. A major difficulty in isolating
the impact of taxation on growth arises because key non-tax variables such as public expenditure that are often not independent of tax policy can also affect growth.

Also, the complex interactions among the fiscal and other macroeconomic variables create difficulties. On the expenditure side, it is usually suggested that the net impact on growth (as measured by aggregate output) of the crowding-out effect of public expenditure clearly depends on the relative marginal productivity of the public and private sectors. The externality effect of public expenditure enhances growth by raising private sector productivity. Here, a higher level of such expenditure could achieve a high growth rate. The opposing natures of the crowding-out and externality effects rest on the proposition that the structure of public expenditure, rather than merely its level, would be of considerable importance.

In analysing the composition of public expenditure, the traditional approach has been to divide it broadly into the categories of public consumption and public investment. This classification is important in a dynamic framework because it focuses attention on the impact of public expenditure on private savings and investment and, hence, capital accumulation. Another area of interest in the literature has to do with the complementarity or substitution between public and private expenditure as they affect private savings. Like the case of taxation, the empirical evidence of the growth effects of public expenditure (as a share of GDP) is inconclusive (Ram, 1986).

One reason for this inconclusive evidence is that the direction of causation is usually difficult to ascertain. It is sometimes suggested that another reason for this inconclusive evidence is that the relationship between growth and fiscal variables may not be particularly monotonic over the levels of these variables or over income, or both. In fact, it can be argued that that increasing levels of public expenditure would first raise and then reduce growth.

The combined effect of taxation and expenditure (budget balance) is usually referred to as budget policy. It is usually argued that budget policy may have growth effects that are separate from those related to the absolute level of either taxation or public expenditure, as discussed above. This is usually the case if one considers the stability implications of budget imbalance. A related but distinct case is the possibility of behavioural response from the private sector based on such imbalances (irrespective of the mode of financing such imbalance). In other words, the issue is whether there is neutrality between debt and tax financing of budget imbalance.

On the income distribution side, it is generally agreed that there seems to be a tradeoff between the allocative and distributitional roles of budget policy. The trade-off is seen from the disincentive effects of distortive taxes that are required to finance direct or indirect transfer payments from the rich to the poor. Studies have demonstrated that under fairly general assumptions about (heterogeneous) individual preferences regarding income and work effort, the efficiency cost of pursuing an egalitarian policy could be prohibitively high (Sinn, 1996).

In this traditional view, policies effecting a redistribution of income toward equality would exact an increase in the price of (aggregate) output loss that is likely to be larger than the reduction in income inequality achieved by such policies. Hence, in a dynamic framework, such a view leads to the conclusion that there is an increasing marginal cost, in terms of
growth forgone, of income redistribution, on account of the saving-depression effect of taxation.

This view has been challenged by some strand of researches which argue that redistributive taxation and the expenditure that it finances are a form of social insurance over an economic agent’s lifetime against certain types of risk for which private insurance may not be available. Consequently, redistribution policies could stimulate productive risk taking and output growth, although such behaviour does not necessarily result in greater equality in the after-tax distribution of income. Another view emphasizes the importance of various aspects of financial market imperfections for growth. The point here is that the potential productivity of the poor cannot be fully realized unless they are given the opportunity to participate in financial markets.

Education has been regarded as one of the leading determinants of economic growth since the time of Adam Smith. Over time, many economic growth theories and models (Lucas, 1988) have developed relating education and economic growth. The belief, that education promotes growth has led governments of many developing countries to invest in the education sector. Even the theoretical literature also provides a backing for such a policy. However, the empirical literature has failed to establish a robust relationship between education expenditures and growth.

Quite a few empirical studies have tried to examine the relation between investment in human capital and economic growth. The relationship has been tested for countries such as USA, Pakistan, Tanzania and Zambia, Nigeria and India. The results from the above mentioned papers indicate that education expenditures do affect growth positively. This is mainly due to the fact that high cost of university education offsets the benefits accrued from a university degree. Further, education expenditures since 1960 have been an important determinant of the subsequent growth in per capita incomes for around hundred countries since 1960. However, overall, the empirical evidence is quite mixed.

The direction of causality is from economic growth to education spending and not vice versa. Chandra (2010) has tested for a causal relationship between education investments and economic growth for India for the time period 1951-2009 using linear and non-linear Granger causality methods. He found that there is bi-directional causality between education spending and GDP for India. Thus, it can be seen that overall, the empirical evidence regarding this relationship for India too is quite mixed.

It is argued that those empirical works do not take the negative effects of taxation into consideration. The negative tax effect offsets the positive education expenditures effect. In other words, taxation can alter the positive growth effects from increased public education expenditures. In fact some scholars hold the opinion that rising government expenditures can actually slowdown the growth of an economy (Nurudeen & Usman, 2010).

The government can increase taxes in order to finance rising expenditures. Even if the government increases its borrowing instead of raising taxes, in order to finance its expenditure, then that will compete away the private sector, thus reducing private investment. Furthermore, if politicians increase expenditure in unproductive projects (focusing on quantity rather than quality) in order to gain “cheap popularity” then such
investments will only result in misallocation of resources and as a result, will hamper growth.

3. Methodology

The research design adopted for this research is the ex-post facto research design. This design suits the research perfectly because a basic feature of the ex-post facto research design, is that the data already exist and are not subject to manipulation but can be subjected to detailed analysis to reveal useful empirical relationships among the variables. (Onwumere, 2005). The issue of data is at the very center of research and, also, the nature of data for any study depends entirely on the objectives of the research and the type of research undertaken (Onwumere, 2005). Consistent with the above and in line with previous researches conducted in this area, the nature of data for this study are secondary. The secondary data sources used for this study were from the Central Bank of Nigeria Statistical Bulletin for the various years.

The growth equation model for the study is specified as based on the disaggregated functional areas of government expenditure. Thus, hypothesizing that public educational expenditure, public health expenditure, public agriculture expenditure and public transportation and communication expenditure do not have positive and significant impact on economic growth in Nigeria, it was represented as:

\[ GDPPC = a + bEE + bHE + bAE + bCT + \mu \]

Where, \( GDPPC \) - Growth Domestic Product per capita, \( EE \) - Educational Expenditure, \( HE \) - Health Expenditure, \( AE \) - Agricultural Expenditure, \( CT \) - Communications and Technological Expenditure, \( a \) - regression equation intercept, \( b \) - regression equation coefficient, \( \mu \) - Error term.

This study used annual time series data from 1999 to 2016 to determine the impact of government expenditure on economic growth since the beginning of democratic governance in Nigeria. The essence is in sectoral allocation of government spending. In the empirical analysis, the investigation will be carried out using the Ordinary Least Square (OLS).

4. Presentation and analysis of data

4.1. Presentation of data

Table 1 presents the data as extracted from the CBN Statistical bulletin from 1999 to 2016 for government expenditure in education, health, agriculture, communication and transportation and real gross domestic product of Nigeria for the period.
Table 1 shows that from 1999 to 2016, government expenditure on education increased from 43.61 billion naira to 341.88 billion naira. The increase could be attributed to effort to increase the rate of education in the country. It could be observed from the table that there was an increase from year to year of government expenditure. Government expenditure on health from the table above also showed an increase from 1999 to 2016. Expenditure on health was 16.64 billion naira in 1999 and this rose to 202.36 billion naira in 2016. A cursory look at the table again indicates that over the period there was fluctuation in government expenditure on health. On Agriculture, it shows that government expenditure also increased from 59.32 billion naira to 36.58 billion naira from 1999 to 2016. On government expenditure on communication and transportation for the period again indicates similar trend. The gross domestic product of Nigeria on the other hand had witnessed a steady increase from 1999 to 2016. The gross domestic product of Nigeria was 5,307.36 billion naira in 1999, the gross domestic product rose to 101,489.49 billion naira in 2016.

4.2. Analysis of data

Table 2 presents the regression results.
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**Table 2. Regression results**

| VARIABLE | COEFFICIENT | STD. ERROR | T-STATISTIC | PROB.  |
|----------|-------------|------------|-------------|--------|
| LOG(EE)  | 0.428824    | 0.336125   | 1.275788    | 0.2244 |
| LOG(HE)  | 0.687826    | 0.289192   | 2.378441    | 0.0334 |
| LOG(AE)  | -0.070917   | 0.095860   | -0.739792   | 0.4726 |
| LOG(CT)  | 0.051702    | 0.082272   | 0.628427    | 0.5406 |
| C        | 5.298009    | 0.589146   | 8.992698    | 0.0000 |

| R-squared | 0.961462 | Mean dependent var. | 10.32054 |
| Adjusted R-squared | 0.949604 | S.D. dependent var. | 0.961164 |
| S.E. of regression | 0.215773 | Akaike info criterion | 0.000950 |
| Sum squared resid | 0.605251 | Schwarz criterion | 0.248275 |
| Log likelihood | 4.991454 | Hannan-Quinn criterion | 0.035052 |
| F-statistic | 81.08178 | Durbin-Watson stat | 1.549851 |
| Prob(F-statistic) | 0.000000 | |

From Table 2, government expenditure on education has a positive and insignificant impact on economic growth. This is indicated by the coefficient of EE = 0.428824 and t-value = 1.275788. Government expenditure on health has a positive and significant impact on economic growth. This is indicated by the coefficient of HE = 0.687826 and t-value = 2.378441. Government expenditure on communication and transportation has a positive and non-significant impact on economic growth. This is indicated by the coefficient of CT = 0.051702 and t-value = 0.628427. Government expenditure on agriculture has a negative and non-significant impact on economic growth. This is indicated by the coefficient of AE = -0.070917 and t-value = 0.4726. The coefficient of determination (r²) was 0.961462 (96.14%). This indicates that the variation in the dependent variable was succinctly captured by changes in independent variable. This was properly adjusted to 0.949604 (94.96%) as revealed by the adjusted r². The probability is 0.00 < 0.005.

5. Conclusion and recommendations

Over the last decade, the growth impact of fiscal policy has generated large volume of both theoretical and empirical literature. However, most of these studies paid more attention to developed economies and the inclusion of developing countries in case of cross-country studies were mainly to generate enough degrees of freedom in the course of statistical analysis. There is a popular assertion in the empirical literature that public spending is negatively correlated with economic growth due to inefficiency of the public sector especially in the developing countries where large proportion of public spending is attributed to non-development expenditure like defense and interest payments on debt and Nigeria is not an exception.

The relationship between government expenditure and economic growth has/is continuing to generate series of debate among scholars. Various studies on the impact of government expenditure on economic growth are inconclusive. Some theoretical as well empirical studies have that government have positive impact on economic growth while others say
there is no relationship. Government performs two functions protection and security and provisions of certain public goods. Therefore, no matter the impact of its activities funds must be committed to achieve these two basic functions. It is obvious therefore from literature that for any country to experience significant changes in its status, there is need for a well-designed and holistic execution of both fiscal and monetary policy in that country. Public expenditure as one of the significant fiscal policy has its own multiplier effect on the organizations within the economic environment. Fiscal policy has both direct and indirect effect on industries.

The policy primarily create enabling environment for the industries to perform. Government expenditure has capacity to influence the dynamics of industrial growth through its consequences for the effectiveness of resources allocation and accumulation of productive resources. The rate at which corruption, misallocation of resources and mismanagement of funds are increasing in government circle caused a great concern on whether the public expenditure actually impact positively on economic growth. This study recommends that Nigerian Government needs to pay more attention to its expenditure in the educational sector. Education is the means through which the citizen is empowered for greater heights, thus funding the educational sector will assist in enhancing the productive base of the country. Also, Health is wealth and the impact of expenditure on health was found to be positively related to economic growth. Though expenditures on national security transportation and communication were positively related to economic growth, the impacts were not statistically significant. It is possible that in the long-run, expenditure on education could be positive if brain drain could be checked and lastly, In as much as government is trying her best to see that education is better funded to promote economic growth in Nigeria, the impact of this funding is not felt. One of the reasons could be due to the fact that the money spent on education is not translated to economic gains in the domestic economy. The gains are being transferred to other economies in the form of brain drain, which is a reduction in the level of GDP.

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