



3

Modeling Expansionary Budget in Kaduna State using Error Correction Mechanism

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Abstract

This paper analyzes the long run relationship among the major variables (economic, administrative, regional development and social) used in formulating the expansionary budget in the Kaduna State. The expansionary factor captures the rate of changes in budget covering the period from 1988 to 2015. Time series data obtained from the yearly budget as expended by the Kaduna State Ministry of Budget and Economic Planning. The data were tested for stationarity using Augmented Dickey Fuller (ADF) and Philip –Perron (PP) and the result shows that the variables are stationary at first level. Based on this result Johanson – Juselius co-integration test and error correction model were used to check for long run relationship among the major variables. The error correction mechanism revealed that all the variables showed the expected sign, hence constant term displayed that if all the exogenous variables are held constant; 46.41 Per cent of the Kaduna State GDP is from other sources not captured in the model. However, the coefficient of ECM (32.64 Per cent) indicates fast pace to long run equilibrium adjustment. The implication of this finding is that an increase in any of the variables will bring about a proportionate increase in the general development in the State, especially when it reflects the general needs of the people and it is judiciously implemented. In view of this, the study recommended that more synergy among all the agencies or bodies involved in the formulation of budget to clearly state the strictly budget disciplines and guideline for implementation.

Keywords: Expansionary Budget, Unit Root, Co – Integration, Error Correction Mechanism, Long – run Relationship, Kaduna State GDP, GDPC

INTRODUCTION

Fiscal policy measures especially budget remains a veritable tool in public expenditure expansions that is mostly used to guide public finance and spending. Every tier of government prepare annual budget as a roadmap which is mostly subjected to scrutiny by the legislative arm of government to ascertain its relevance and how it will have an expected relative effect in the life of the general populace.

Nations all over the world make annual budgetary provisions that would be used as means of enhancing the needed economic growth and development. Budget impact can only be felt if prompt attention and the needed wherewithal to implement it is put in the front burner of policy dispensation. It is on this premise that the study; seek to test the long run relationship for expansionary budget modeling in Kaduna State to verify its economic tendencies that would improve on the infrastructural development as well as the living standard (Abdullahi, 2011).

The fiscal policy that style on expansionary budget was first explained by John Maynard Keynes during the economic recession of the 1920s. Thereafter, it became an economic policy tool that is widely used to salvage an ailing economy and a means of improving economic malfunctioning or its resuscitation (Keynes, 2012).

Expansionary budget as it is being experienced in recent times in Kaduna State presents an empirical phenomenon that requires investigation to unveil whether the phenomenon has a long run equilibrium relationship. Accountant General Annual Report of Kaduna State (2013) states, that budget implementation has been poor on account of serious shortfalls of revenues over planned expenditure. The trend, according to the report, became worse in Kaduna State especially from 2005 when revenue receipts were 34 per cent less than budgeted. The gap between the budget and revenue receipts continued to increase, the shortfall being 42 per cent in 2006, 56 per cent in 2007, 59 per cent in 2008, 55 per cent in 2009 and 63 per cent (capital receipts only) in 2010. It is obvious that budgets have not achieved the social and developmental objectives of the State because they have been unrealistic in conception, content and execution. It is the dwindling nature of the State budget and making an unrealistic budget for Kaduna State that brought the UK Department for International Development in partnership with the State, which has been working in Nigeria since 2006 (SPARC, 2014).

This study intends to unveil how expansionary budget could be modeled from budgetary expenditure of Kaduna State. This intention was informed by the fact that there was scarcity of empirical data from the available data on this topic at the disposal of the researcher regarding the expansionary budget both at the Federal or state level in Nigeria. This gap was intended to be filled through the provision of empirical analysis using econometric models. Hence, the study would provide answer to; Is there any long run relationship for expansionary budget modeling in Kaduna State? And this task is informed by the general rationale of the study which is to examine the impact of modeling expansionary budget using error correction model on the general welfare of people in Kaduna State. But the specific objective is to determine the long run relationship of expansionary budget modeling in Kaduna State. In the end, this study will validate or otherwise the null hypothesis "modeling expansionary budget has no long run relationship in Kaduna State".

Hence, this paper is made into five sections. Section one is the introduction, section two deals on the conceptual issues, literature review as well as theoretical review while section three centres on the methodology and model specification. The next section is data presentations after which the discussion of findings follows. The last two are conclusion and recommendation, as they serially follow each other, from the empirical findings of this study.

CONCEPTUAL ISSUES, LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Conceptual Issues

A budget process is a system of rules governing the decision - making that leads to a budget; from its formulation, through its Legislative approval, to its Executive assenting to it and its evaluation. Ekeocha (2012) quoted Bills & Keith who stated that budget is rooted in the constitutional mandates, statutory requirements, House and Senate rules and practices (as in the federal level), and administrative directives. The Budget process dictates both the degree to which a policy debate can actually occur as well as the policy outcomes.

The budget is officially referred to as the Appropriation Act, is introduced by the Executive, approved by the Legislature and signed into law by the President.

Edame & Ejue (2013) defined as an estimate of the expected income and expenditure of the government for a specified period of time, usually one year. It is a functional plan making and consequent control of expenditure. The budget is an essential instrument in the planning and control of the financial affairs of a country.

Olaoye & Odunmakin (2014) is a word commonly used today which got its name from a French word "Bougettee" implying little bag in 1733. In Britain, it was used to describe the leather bag in which the then Chancellor of the Exchequer - Walpole - used to carry to the parliament the Statement of governments needs and sources as described by several thought of consensus. Hence the word budget became the document contained in the bag which represent plans of government expenses in money and submitted to the legislative arm of government for approval. International Monetary Fund (2012) stated that expansionary budget is a kind of fiscal policy tool which aims at increasing demand and thus output of the economy. This is achieved through rising government expenditure, reducing taxes or doing a bit of both.

Expansionary budget, therefore, is the use of tax cut to facilitate increase in consumers' disposable income of individuals as well as rising government spending with alternative forgone; like debt financing, deficit spending, inflationary tendencies and lower GDP. This policy is applicable when an economy is in recession; and government wants to enhance aggregate demand in order to get the utilization of resources to its full employment.

Theoretical Review

The foundation of the theory of coordination failure is the idea that the market may fail to achieve coordination among complementary activities in the economy. When complementary exists, that is when returns of on investment depend on the presence or extent of other investments, there exist two scenarios. On the one hand, optimally, all investors as a whole are better off with all investments to achieve at the same time. On the other hand, it would not make sense for an investor to take similar actions when he believes that others may not do same as well. The market is said to have failed to coordinate investors' actions in this way. Coordination failure therefore leads the market to an (equilibrium) outcome inferior to a potential situation in which resources would be optimally allocated and all agents would be better off. As a result, underdevelopment equilibrium is possible (Hoff & Stiglitz, 2000).

The theory of coordination became influential in the 1990s. However, it has a history of more than half a century. Coordination issues among complementary industries were first raised by Rosenstein - Rodan (1943). Like Rosenstein - Rodan (1943), early coordination failure economists Nurske (1953) and Hirschman (1957) emphasized the role of government to solve problem. In order to reach an optimal level of coordination, the policy they recommended was a "big push", a

public – led massive investment programme, which can cause complementarities to take place in the rest of the economy.

Like other early development models, “big push” strategies ran out of favour when the world witnessed the collapse of centrally planned economies and slow growth, stagnation or worst results of State – led industrialization in the underdeveloped countries (Meier, 2000). However, development economists have recently returned to emphasize the problem of complementarities between several conditions necessary for successful development to take place (Glavan, 2008). Hoff (2000), and Bowles Durlauf and Hoff (2006) described the economy as an ecosystem where the behaviour of one can affect the other. The coordination failure among many different individuals led the economy to multiple equilibria, but not all of them are good for every member of the economy, and some in fact are very undesirable. As a result, the market fails to coordinate everyone to achieve the optimal equilibrium needed. In other words, “A firm’s productivity depends not only on its own efforts, and abilities, and on general economic conditions (for example, the macroeconomic environment and the legal system), but also on the actions of other firm, infrastructure, regulation and other public goods” (Rodriguez – Clare, 2005). In similar vein, Rodrik (2004) also indicates that success or failure of an action could depend on its peculiarities.

In market mechanism, there are uncertainties that goods equilibrium can be obtained. A bad equilibrium can exist when firms have pessimistic expectations and thus show their reluctance to invest, and consequently fail to coordinate their businesses. “And whereas in the past we thought the implication was that the economy would be slightly distorted, it is now understood that the interaction of this slightly distorted behaviour may produce very large distortions. The consequence is that there may be multiple equilibria and that each may be inefficient” (Hoff & Stiglitz, 2000). The existence of coordination failure cannot therefore be disputed and has become very important. When the market mechanism does not work, the active roles of the government need to be highlighted. According to coordination failure economists, in the multiple equilibria circumstances described above, the government can coordinate firms to move them into the domain of good equilibrium.

The theory of coordination failure offers some pertinent lessons for policy – makers. The theory often highlights the problems of market failure that require selective government intervention to ensure that several things work together at the same time. However, to get sustainable development underway is clearly not an easy task. The “big push” strategy is recommended recently by United Nation Development Programme (2005). The programme suggests that for developing countries to break out of poverty trap, a big push of basic investments between now and 2015 in public administration, human capital development and key infrastructure is necessary (UNDP, 2015).

However, the theory of coordination failure has been criticized of its overemphasis on the role of government. Critics have argued that the government may be ineffective and could choose a bad policy (Killick, 1976; Hoff & Stiglitz, 2000). If such a bad policy is implemented, it can push an economy into a bad equilibrium for years to come and even into a worse equilibrium than the one with which the country began (Hoff & Stiglitz, 2000). Moreover, the policies recommended by coordination failure models lacked details of how the government can coordinate the economy. The policy – makers therefore need to be more cautious of these strategies to address coordination failure issues.

From the above analysis of the theoretical review, neoclassical growth theorist believed that government interventions would cause distortions in reacting the desired economic goals; new growth theorist are of the view that individuals agents in an economy cannot maximized all their gains in free market but the policy intervention of government is considered necessary; while coordination failure theorists agreed that government must intervene to coordinate market activities through the provision of infrastructural and enabling environment for economic activities in other to increase economic growth. However, this study would adopt the coordination failure theory as its basis of analysis because the government's ability to use the concept of 'big - push' which can easily be done through the use of budget implementation to influence both the social and economic activities. More so, Kaduna State has this opportunity of using fiscal policy tool (Budget) to improve on the standard of living of her citizens. And this will help us to analyze the various budget implemented in the State whether it has a strong relationship with this concept or not.

Literature Review

In another study, econometric analysis of the impact of fiscal stance on economic growth in Nigeria, revealed that fiscal impulse response results indicated that fiscal stance are relatively more vulnerable to government deficit and revenue shocks from oil and exports. This was achieved through the use of econometric techniques such as descriptive statistics, stationarity test, co - integration test, multivariate granger causality in vector error correction model (VECM), variance decompositions (VDCs), and Impulse response functions (IRFs); the data gathered from 1970 to 2010 (Tajudeen & Adedokun, 2012).

In a study on "budget and implementation of public policy in Nigeria", it was found out that incessant budget failure often happen at the stage of formulation and implementation. They argued further that factors responsible for the failure were; delay in preparation, late submission and appropriation, cumbersome bureaucratic process of securing release of funds, shortfall in revenue, poor implementation plan and above all corruption. The study which was done using content analysis was concluded by suggesting way forwards that includes; effective monitoring, timely submission of budget to the legislature by the presidency, discouragement of unnecessary lobbying of national assembly by ministries departments and agencies as well as avoidance of temptations of allocating huge amount to new projects while the on - going projects are starved of funds (Eghe & Paul, 2015).

In a content analysis perspective on the effect of dominant individuals on budget implementation in Nigeria by Nwaorgu (2015); it revealed that the activities of dominant individuals ranges from manipulation of budget items before and after approval of annual estimates; embezzlement and fraudulent activities; lack of proper budgeting process are responsible for the failure of budget in Nigeria. He recommended therefore that there is need for budget reform in Nigeria so as to avoid the implication of persistent high level of youth unemployment, poverty and corruption in the face of under development of the Nigerian economy.

Ejubekpokpo, Sallahuddin & Clark (2015) found in their study that fiscal policy could be used to improve on investment expenditure in Nigeria. The study used Ordinary Least Square (OLS) techniques for its estimation and advised the government to use an expansionary fiscal policy to encourage increase in investment in Nigeria and that government spending to be channeled to capital project and social overhead capital that will encourage investment and improve economic activities.

METHODOLOGY AND MODEL SPECIFICATION

This work examines the long run relationship for expansionary budget modeling in Kaduna State using a time series data covering the years 1988 to 2015. Hence, the study employed econometric techniques of Augmented Dickey-Fuller (ADF) Unit Root Test, Johansen & Juselius Co-integration Test, Engel & Granger Causality Test and Error Correction Mechanism (ECM). This methodology was chosen because of the need to examine both the short run and long run reactions of the variables of interest.

The variables used in this study are Gross Domestic Product per Capita (GDPC) for Kaduna State representing the dependent variable while the explanatory variables are Economic Sector Expenditure (ESE), Administrative Sector Expenditure (ASE), Regional Development Expenditure (RDE), Social Sector Expenditure (SSE) as well as Expansionary Factor (EXF).

$$GDPC = f(ESE, ASE, RDE, SSE, EXF) \tag{1}$$

Where;

- GDPC = Kaduna State Economic Growth and Development
- ESE = Economic Sector Expenditures
- ASE = Administrative Sector Expenditures
- RDE = Regional Development Expenditures
- SSE = Social Sector Expenditures
- EXF = Expansionary Factor
- f = functional relationship

Econometric model

The econometric model captured in the form

$$GDPC_t = \alpha + \beta X_t + \epsilon_t \tag{2}$$

Where, X represent all the independent variables, and

The model is expressed in natural logarithms as follows;

$$LNGDPC_t = \beta_0 + \beta_1 LNESE_t + \beta_2 LNASE_t + \beta_3 LNRDE_t + \beta_4 LNSSE_t + \beta_5 LNEXF_t + \mu_t \tag{3}$$

Where;

- GDPC = Economic Growth and Development
- ESE = Economic Sector Expenditures
- ASE = Administrative Sector Expenditures
- RDE = Regional Development Expenditures
- SSE = Social Sector Expenditures
- EXF = Expansionary Factor
- μ = error term

But

GDPC = dependent variable, while ESE, ASE, RDE, SSE and EXF are independent variables, and

β_0 = constant, $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ are the parameters for each of the variables, while

$\beta_0 > 0$ and $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5 \neq 0$

The related estimated error correction model is specified in its linear form as:

$$LNGDPC_t = \beta_0 + \beta_1 LNESE_t + \beta_2 LNASE_t + \beta_3 LNRDE_t + \beta_4 LNSSE_t + \beta_5 LNEXF_t + ECM_{-1} + \mu_t \tag{4}$$

PRESENTATION OF RESULTS

Unit Root Test (ECM has unit root)

Time series data always require that test for unit root is done in order to ascertain the spurious nature of the data. In this case, instead of looking at the various variables of the model for ECM, the residual of the regression from the error correction model is used to test for unit root which will suffice to explain the spurious nature of the collected time series data, using ADF.

Table 3.1: Unit Root Test (ECM has unit root)

Variables	ADF Test Stationarity	P - Values	Status of Stationarity	Order of integration
ECM	-3.125535	0.0356	I(1)	I(0)
ADF CV @ level	1% = -3.959148 5% = -3.119910 10% = -2.701103	&	10% Stationary	
ECM	-6.179793	0.0000	I(1)	I(1)
ADF CV 1st diff	1% = -4.057910 5% = -2.916566 10% = -2.596116	&	10% stationary	

Source: Author's Computation (2017) Eviews 7.0

From the Table 3.1, the calculated ADF is greater than the ADF critical values; it reflects that the model is stationary only at 10% level of significance. This implies that the model has no unit root; that is, it is stationary at this level.

Further test is carried out what happen at first difference to see whether the data will change or strengthen the result at level. The observed values in their absolute terms are statistically significant compare to the ADF statistics at 1%, 5% and 10% levels. It shows that the model is stationary at first difference. Thus, it remains much better that the test of stationarity at level.

Long Run Estimate

Table 3.2: Long Run Estimate

Variables	Coefficients	Std Error	T - Statistics	Prob. Values
C	3.977249	0.926529	4.292633	0.0003
LNESE	0.600578	0.560865	1.070807	0.0259
LNASE	0.497138	0.488044	1.018633	0.0194
LNRDE	-0.243022	0.412668	-0.588904	0.5619
LNSSE	0.270041	0.071267	1.916279	0.0307
LNEXF	0.742478	1.424739	0.521132	0.0075
R-Squared: 0.908780			Adjusted R-Squared: 0.888048	
F-statistic: 43.83479			Prob (F-statistic): 0.000000	
Durbin-Watson Stat: 1.883487				

Source: Author's Computation (2017) Eviews 7.0

Table 3.2 reveals that there are long run impacts of the explanatory variables on the dependent variables. It shows that some independent variables (ESE, ASE, SSE & EXF) are positively related to the dependent variable while only RDE is negatively related to the dependent variable. From the coefficient of the variables, an increase in variables (ESE, ASE, SSE & EXF) will lead to an increase of 60.06 per cent, 49.71 per cent, 27.0 per cent and 74.25 per cent respectively in GDPC. Likewise, a unit increase in variables (RDE) will lead to a proportionate reduction of about 24.30 per cent respectively in the GDPC. In addition, looking at the expansionary factor, it has the larger positive multiplier; meaning that the budget figures over the years under review are in geometric progression.

Error Correction Mechanism

Error Correction Model indicates the degree at which the model responds to adjustment from the independent variables to the dependent variables. Below is the outcome of the model.

Table 3.3: Presentation of ECM Model Result (GDPC)

Dependent Variables: D(LNGDPC)				
Method: Least Squares				
Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	0.464135	0.396955	1.169238	0.2568
LNGDPC(-1)	1.031262	0.083043	12.41845	0.0000
LNESE	0.243240	0.169331	1.436474	0.0471
LNASE	0.127956	0.151148	0.846560	0.0378
LNRDE	-0.158285	0.126087	-1.255367	0.2246
LNSSE	0.136568	0.071267	1.916279	0.0305
LNEXF	0.706930	0.431993	1.636439	0.0182
ECM(-1)	-0.326378	0.076758	0.343647	0.0049
R-Squared	0.992293			
Adjusted R-Squared	0.989454			
Durbin-Watson Stat	2.170359			
F-statistic	349.4803			
Prob(F-statistic)	0.000000			

Source: Author's Computation (2017) Eviews 7.0

DISCUSSION OF RESULTS

From the estimated result of the ECM above, Table 3.3, it revealed that some of the apriori expectations of all the variables were fully satisfied while the explanatory variable RDE behaved otherwise. But the expected sign for the ECM was very much satisfied. This implies that the coefficients of the explanatory variables (ESE, ASE SSE & EXF) were positive; indicating that a unit change in each of these variables will lead to rise in GDPC absolutely by 24.32 per cent, 12.80 per cent, 13.66 per cent and 70.69 per cent respectively. While on the other hand, the explanatory variable (RDE) is negative; showing that a unit rise in the variable will cause a reduction in GDPC by 15.83 per cent. It could be derived from this explanation that some of the explanatory variables used in this model display positive relationship as well as negative impact on the GDPC of Kaduna State for the period under review.

Taking into cognizance of the signs and magnitude of the coefficients that signify the impact of explanatory variables on the Kaduna State GDPC, it is observed that the model has explanatory variables that obey the expected signs. The constant term from the regression is 0.464135; meaning that if all the exogenous variables are held constant, the GDPC is improved by 46.41 percent from other sources not captured in the model. The lag of GDPC by one year GDPC (-1) is 1.031262. This coefficient implies that a unit increase in the previous year GDPC (-1) cause an increase in the current GDPC by 103.13 percent. In addition, the coefficient of ECM with value (-0.326378); implies that the speed of adjustment is 32.64 percent. This indicates that the rate of equilibrium adjustment to long run whenever there is temporary disequilibrium would be relatively very fast. The response to any shock or distortion in the model would be relatively fast. The coefficient of multiple determinations; R² and its adjusted R² are 0.992293 and 0.989454 respectively. Hence, the R² shows that 99.2 percent of the total variation in the dependent variable (GDPC) is explained by the changes in the explanatory variables (ESE, ASE, RDE, SSE and EXF) of the estimated model. The difference of about 0.01 percent is not explained by the model or white noise residual. This implies that the estimated model has a good fit in the long run. The adjusted R² (0.989454) shows that the systematic variation in the dependent variables is explained by over 98 percent of the regressors. However, the value of F - statistic (349.4803)

depicts that the parameters of the estimated model are jointly and statistically significant. So, the inference from the estimated results could be taken as valid for policy purpose.

The value of Durbin - Watson (d) statistic (2.170359) signifies that there is absence of autocorrelation among the variables. Therefore, the above value of Durbin - Watson of 2.2 is implying that there absence of autocorrelation in the estimated model. Hence, the forecasting power of the model could be considered as reliable, which are evidence from the power of the explanatory variables used with high value of adjusted R^2 .

These findings agree with the studies of scholars among who are Ocheni, Atakpa & Nwankwo, (2012); Tajudden & Adedokun (2012); Ejubekpokpo, Sallahuddin & Clark (2015) and so on. Ejubekpokpo, et al (2015) found out that fiscal policy could be used to impact on investment expenditure in Nigeria. This study used Ordinary Least Square (OLS) techniques for its estimation and advised the government to use an expansionary fiscal policy to encourage increase in investment in Nigeria; thereby leading to economic growth and development. Also, the findings agree with Tajudeen & Adedokun (2012) who used econometric analysis to check for the impact of fiscal stance on economic growth in Nigeria, revealed that fiscal impulse response results indicated that fiscal stance are relatively more vulnerable to government deficit and revenue shocks from oil and exports. The study affirmed that there is causal relationship among the variables which shows that government deficit financing a research work on budgeting role, infrastructural development and economic growth in Nigeria.

CONCLUSION

The explanatory variables in the study explain a greater proportion in changes in Gross Domestic Product per Capita, however, it was realized that Rural Development Expenditure (RDE) was insignificant thereby signifying that (RDE) has not adequately impacted on GDPC of Kaduna State. On the other hand, Economic Sector Expenditure (ESE), Administrative Sector Expenditure and Social Sector Expenditure (SSE) considerably influenced GDPC, while Expansionary Factor (EXF) actually presage that it has appreciable relationship with GDPC implying that it correlates with standard of living of people in the long run in Kaduna State.

However, the OLS result shows that there is indeed a linear relationship among the independent variables and dependent variable. In addition, adjusted R^2 in the model suggests that the explanatory variables have a significant impact on Kaduna State GDP. The study, therefore, concludes that expansionary budget contributes to standard of living of the people in Kaduna State.

This is in line with study that fiscal policy could be used to impact on investment expenditure in Nigeria. This study used Ordinary Least Square (OLS) techniques for its estimation and advised the government to use an expansionary fiscal policy to encourage increase in investment in Nigeria; thereby leading to economic growth and development (Ejubekpokpo, Sallahuddin & Clark, 2015).

Other related finding, like Ocheni, Atakpa & Nwankwo, (2012) has it in his findings that the problem responsible for the great expectations not matching with the realities on ground is lack of budget discipline. This assertion was made in a critical review of financial governance and sustainable development in Nigeria

RECOMMENDATIONS

This study has brought to the fore the relevance of expansionary budget on Kaduna State Gross Domestic Product per Capita (GDPC). The findings of this study, the under listed recommendations may be used to guide the programmes, policy formulation and implementation of expansionary budget to improve on the standard of living of the people of Kaduna State.

- i. The model of this study could be adopted by government to take a decision during budget process so as to know the level of expansion for the current year that is adequate in the light of the previous year. Policy makers could adopt or adapt the model in order to draw an effective implementation plan that will last for sustainable development of the Kaduna State.
- ii. In the end, it call for more synergy among all the agencies or bodies involved in the formulation of budget to clearly State the budget disciplines and guideline for implementation which must be strictly adhered to the later in order to ensure that the intended impact is achieved.

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