
Impact of fiscal policy instruments on aggregate consumption expenditure in Nigeria

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ABSTRACT

This study investigated the impact of fiscal policy on aggregate consumption expenditure in Nigeria. Using the standard error correction mechanism (ECM), the study explored time-series data from the Central Bank of Nigeria between 1980 and 2020. The St. Louis modeling approach was used to investigate the relative effectiveness of fiscal policy instruments in altering aggregate consumption expenditure in Nigeria. Government expenditure, tax revenue, and disposable income were perceived as fiscal policy tools that influence Nigeria's aggregate consumption expenditure. The results of the cointegration test for all specifications confirmed the prevalence of long run relationships among the variables of the estimates. An increase in government expenditure propels a rise in aggregate consumption, an increase in disposable also increases aggregate consumption in Nigeria. However, increase in tax plummets consumption. We recommend that the monetary experts should fashion out an appropriate fiscal policy that will enhance rather than inhibit consumption in Nigeria.

KEYWORDS

fiscal policy; consumption expenditure; aggregate consumption

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INTRODUCTION

Consumption stimulates production and promotes growth. It is a major component of change in aggregate demand and understanding the macroeconomic policy changes (fiscal) that influence consumption expenditure in Nigeria is necessary. This is why macroeconomists all over the world are concerned about consumption expenditure in the long term and short-term perspectives. Consumption affects various sectors of the economy directly or indirectly and thus, plays a vital role in macroeconomic policy shifts.

Taking the huge importance of aggregate consumption as an example, it's critical to understand the sources of variance in aggregate consumption. Variations in consumption expenditure have been linked to changes in fiscal policy over time, in addition to the traditional determinants of consumption expenditure. The variables of fiscal policy that affect consumer spending, on the other hand, remain an open and unresolved question. Despite the literature's clear claims that consumption is linked to government expenditure and tax, the usefulness of these policy instruments for measuring consumption expenditure is still a hot topic of discussion (Mankiw, 2005). Some of these controversies have lingered on whether fiscal policy tools are successful at stimulating and stabilizing consumer spending (Gbosi, 2015). The way and manner in which fiscal policy instruments are manipulated to influence demand in an economy remains the central point of this research, based on this assumption.

As a result of the stylized facts discussed above, it becomes clear that increased consumer spending has the potential to raise overall demand in an economy, which is critical for rising aggregate production. However, the situation in Nigeria remains such that, despite the fact that consumption spending accounts for a sizable portion of the country's GDP, it has yet to translate into an increase in Nigerian households' living standards. This may be attributed to high inflation and low per capita income in emerging economies like Nigeria (Fasoranti, 2012).

In order to keep up with the evolving global economy, it is expected that a country like Nigeria will follow sound fiscal policy that can exert a strong moderating effect on consumer spending in order to ensure higher per-capita income and a better quality of life. The key aim of fiscal policy, according to the CBN's policy framework, is to preserve price stability with low inflation in order to promote the maximum possible sustainable production growth.

However, since consumption expenditure is linked to both demand growth and cyclical fluctuations, any fiscal policy misalignment is more likely to precede an erratic consumption trend, which could lead to macroeconomic volatility (Anderson-Jordan, 1968). As a result, knowing how individuals tailor their consumption habits to the economic climate in which they live is critical knowledge that can lead to policy recommendations that are most likely to shape policymakers' expectations (Ademola, 2010). As a result, one of the issues that this research on the relationship between macroeconomic policy and consumer spending is concerned with is the degree to which aggregate consumption shifts in response to changes in fiscal policy instruments. This makes the following research questions important in the Nigerian economy, among other things: What impact does fiscal policy have on Nigerian consumption pattern? Is the government expenditure, tax revenue and the money supply more efficient fiscal policy instruments in Nigeria for controlling consumption?

The relative efficacy of fiscal policy instruments in changing consumer prices in Nigeria will be tested using the St. Louis modeling method.

The most successful solutions are likely to be those that help form policymakers' perceptions. In the literature, for example, two groups argue about the relative efficacy of a strategy in a country's macroeconomic stabilization.

The St. Louis equation was used by Anderson and Jordan (1968), and Carlson (1978) to provide empirical evidence in support of their positions. The objective of this study is to examine if fiscal policy has a greater impact on consumer expenditure in Nigeria. As a result, the study's importance is dependent on the valuable analytical context it can provide for Nigeria's economic reformers and regulators, who are currently attempting to lift the economy out of its slump. If the outcome of this tool (i.e., aggregate consumption's response to fiscal policy) is understood based on the empirical evidence presented in this report, policymakers would be better able to choose the necessary macroeconomic policies to stimulate or stabilize the economy.

LITERATURE REVIEW

This section examines applicable existing hypotheses and empirical results from both micro and macro examinations of household consumption efficiency. In addition, this section considers conceptual clarifications on key issues such as consumption behavior and fiscal policy.

Conceptual Issues

• *Consumption*

Consumption is described as the act of using goods and services to meet man's numerous needs. This covers the significance of consumption in terms of well-being. The amount of aggregate consumer spending on durable and non-durable products reveals an economy's overall status. Consumption is regarded as the focal point of an economy's productive success by neoclassical (mainstream) economists, who consider consumption to be the end point aim of economic activity. It is characterized as private individuals' spending on goods and services such as clothing, food, entertainment, health care, and asset acquisition, among other things.

• *Fiscal Policy*

Fiscal policy conceptually implies the management of public finance, which involves manipulation of government expenditure and revenue in accordance to a country's laid down fiscal policy. A government fiscal policy therefore naturally translates into policy; with emphasis on deliberate actions with which government of a country takes in the area of spending money and or levying taxes, with the objective of influencing macroeconomic variables such as the level of national income or output, the employment level, aggregate consumption level, the general level of prices and

the likes. It is government's programme of taxation, expenditure and other financial operations to achieve certain national goals.

• **Empirical Literature**

This session reviews previous studies and is divided into two sections. The first, carries out the review of the general factors influencing consumption. The second, reviews previous studies on the effect of fiscal policy on aggregate consumption expenditure.

Determinants of consumption expenditure

Sakib-Bin-Amin (2011) used an Auto-Regressive Distributed Lagged (ARDL) bound research method to co-integration to examine the causal association between consumer spending and economic growth in Bangladesh. The findings revealed that consumer spending and economic development are co-integrated in the long term. The study's Granger causality test showed a long-run unidirectional causal association between economic development and consumer spending. Using the framework of ordinary least square (OLS) regression, Ofwona (2013) empirically explores the determinants of consumption spending in Kenya. The outcome demonstrates that wealth determines consumption. Tapsin and Hepsag (2014) examined consumer consumption expenditure in EA-18 using panel data spanning the years 2000 to 2012. As a metric for wages, the gross domestic product (GDP) was used. The findings revealed a favorable association between household. In their own research, they looked into the effect of changes in Nigeria's gross domestic product (income) on private consumption spending. Adedeji (2013) used an error correction model to investigate the determinants of private consumption expenditure in Nigeria, finding showed that inflation, GDP per capita, and disposable income both have a substantial positive impact on private consumption spending. Real GDP rise, foreign direct investment, public expenditure, and changes in the real effective exchange rate, on the other hand, have all been shown to have a negative impact on demand. According to the report, also up to a one-year span, public consumption was crowding out private consumption, and private consumption expenditure was a growing feature of income, as Keynes hypothesized. Nwabueze (2009) used regression analysis to analyze the casual relationship between gross domestic product and household consumption expenditure in Nigeria data set.

According to the results, an improvement in the gross domestic product has no major impact on Nigerian personal consumption spending, and the gross domestic product still accounts for around 3.5 percent of personal consumption expenditure in Nigeria.

Thomas (2013) looked at what factors influence consumption spending in six major cities in Nigeria's Ekiti province. Ado, Ilawe, Ikole, Ikere, Iyin, and Oye were the towns studied. A total of 180 respondents were sampled using a basic random sampling methodology. The Chi-square statistical analysis was used to examine the data gathered. The study reveals that household spending expenditure has a substantial association with income level. The study also found that people in both the upper- and lower-income groups tend to spend the same percentage of their income on consumption. As a consequence of the findings, the study concluded that the government could raise worker wages in order to improve their quality of life. Using the Keynes' absolute income hypothesis. Apere (2014) examined the household spending expenditure feature in Nigeria. In order to estimate the equation, the researchers used co-integration and error correction mechanism (ECM) techniques. The co-integration test revealed a long-term association between the variables. The findings of the parsimonious error correction model revealed that household consumption spending and national income have a favorable relationship. As a result, the study established that the Nigerian consumption mechanism follows the Keynesian hypothesis. The multiplier impact of an autonomous adjustment in government or investment spending was 12.5, showing the relevance of a viable monetary strategy in the economy, with a strong marginal propensity to consumption out of income of 0.92. To increase national revenue, a good public-private relationship was recommended.

Fiscal policy and consumption expenditure

Kwan (2006) empirically investigated the relationship between government spending and private consumption for East Asia countries using annual time series data spanning from 1960 to 2002. The study adopted the panel co-integrating

regression. The results of panel regression show that on average government spending and private consumption are substitute in East Asia. However, the cross-section analysis revealed that the value of elasticity of substitute is moderate for China, Hong Kong, Japan, and Korea, while high for Malaysia and Thailand and zero for Philippines. However, in case of Indonesia and Singapore it is complementary.

Chalk (2010) investigated the effect of government social spending (i.e. spending on health and education) on private consumption of China. The results of the study revealed that a 1 RMB increase in government spending on health leads to increase urban households' consumption by 2 RMB, while education spending has no effect on households' consumption.

Murphy (2013) examined the recent contradictory evidence to new Keynesian and neoclassical models that an increase in government spending boost aggregate private consumption. The study developed the imperfect information framework based on studies of Lucas and Robert (1972) and Lorenzoni (2009). The model of the study targeted the owners of firms that increase in government spending increase the permanent income of the firms' owners relative to future tax liabilities, when the owners of the firms are not aware about future tax liabilities in such a case government expenditure leads to increase aggregate private consumption otherwise permanent income.

Dada (2013), empirically examined the composition effect of government expenditure on private consumption and output growth in Nigeria using the framework of single equation error correction mechanism while the cointegration technique was employed to confirm the existence of cointegration among the variables included in the model. The variables captured in the study were government expenditure on health, education, defense, administration, transport and communication as well as government expenditure on construction. Other variables captured in the study were Gdp at current basic prices, stock of money in the economy and private consumption expenditure. The study utilized annual time series data covering the period 1961-2010. Findings from the study confirmed the existence of cointegration among the variables implying that government expenditures have long-run effect both on private consumption and output. The study also found that government spending on education and health as well as social security has crowding-in effect on private consumption while government spending on administration, construction, agriculture, transport and communication have crowding-out effect on private consumption during the period under evaluation. The study therefore recommended that the government should demonstrate high level of transparency and prudence in the budgetary allocation and execution to ensure an effective management of public funds to prevent leakages as a result of contract inflation and looting of treasuring which are prevalent in most developing countries. Employing the use of panel unit root test and the dynamic ordinary least square estimator Chen, Luan and Huang (2014) also analyzed the effect of government expenditure on private consumption in 29 provinces of china utilizing time series data spanning from 1996-2013. Government spending on economic construction, education and culture as well as administrative management were some of the variables captured in estimating the relationship between government spending and consumption in china. The results obtained from the study showed that increase in government spending on economic construction and administrative management impacts negatively on private consumption while spending on culture and education crowds in private consumption. However, the study concluded that increase in aggregate level of government spending has a positive effect on private consumption.

In a similar but slightly different vein, Khan, Fei, Kamal and Ashraf (2015) also examined the impact of government spending in china adopting the Auto regressive distributed lag techniques in estimating the long and short run effects of the model while annual data covering the period 1985-2013 was utilized. Findings from the study revealed that government spending has almost the same impact on private consumption in both long and short run, but the coefficient of government spending is statistically insignificant in the short run. The study therefore concluded that government spending has positive relationship with private consumption in China during the period under consideration and recommended that government should increase its spending so as to boost the economy and increase aggregate demand. Employing the panel data estimation technique, Arab and Haghghat (2014) studied the impact of government spending on private sector consumption of 22 OECD countries. The study utilized annual data spanning from 1998-2012. The results obtained confirm the existence of a long run relationship among the variables employed in the study.

Also, the results of the model using fixed effects method showed the existence of a positive relationship between government spending and consumption in the selected OECD countries. The study therefore concludes that government spending crowds in private consumption of the selected OECD countries during the period under evaluation.

Using the vector error correction mechanism Kraipornsak (2010) analyzed the impact of government spending and private consumption on the economy of Thailand. The study categorized government spending into government capital spending and government consumption spending while quarterly time series data covering the period 1993:1 - 2009:3 was utilized. Results obtained from the study showed that government capital spending had no effect on private consumption or the growth of GDP while the government consumption spending has negative effect on the growth of GDP. However, the study concluded that there was no crowding out effect of government expenditure on private consumption in Thailand during the period under evaluation.

In another study, Chen, Luan and Huang (2014), conducted a study on the effect of government expenditure on private consumption in China. They employed the annual time series data spanning from 1996 to 2013. The study adopted the dynamic ordinary least squares (DOLS) to estimate its equation. It is revealed from the study that an increase in aggregate level of government spending has a positive effect on private consumption in China. However, an increase in government spending on economic construction and administrative management has negative effect on private investment while government spending on culture and education crowds in private consumption.

Khan, Fei, Kamal and Nadeem (2015) conducted a study on government spending on private consumption in China for the period which spanned from 1985 to 2013. The analysis of the study was conducted under the framework of autoregressive distributed lag approach. Results of the study revealed a positive and significant influence of gross domestic product on private consumption in China. The study also revealed that government expenditure had a significant positive effect on private consumption in the long run in China. However, the study revealed a positive but insignificant impact of government spending on private consumption in the short run. In conclusion, the study found that government spending was a very good instrument to boost economy and encourage aggregate demand in China during recession.

Research Gap

Thus far, extant literature on the determinant of consumption in Nigeria and across have linked consumption behaviour to a variety of economic and socio-demographic factors. These include among others, Kwan (2006), Dada (2013), Chalk (2010), Murphy (2013) and Khan, Fei Kamal and Nadeem, empirically examined the composition effect of government expenditure on private consumption and output growth. Amongst the literature reviewed for Nigeria and beyond, none considered the effect of fiscal policy instruments on aggregate consumption, given that this policy has great influence on aggregate consumption expenditure of every nation. This study, therefore, examines the impact of fiscal policy on aggregate consumption expenditure in Nigeria and also uses the time series data.

Thus, the empirical analysis of the impacts of fiscal policy instruments on aggregate consumption here remains a gap the current study is set to bridge using Nigeria as a case study. More importantly, evaluating the relative effectiveness of fiscal policy for explaining aggregate consumption expenditure utilizing St. Louis modelling approach in the context of Nigerian economy is an innovation that is relatively exclusive to this present study.

METHODOLOGY

The Model

$$\log(CONS) = \beta_0 + \beta_1 \log(GE) + \beta_2 \log(TX) + \beta_3 \log(DY) + \varepsilon_{2t}$$

The model established the impact of fiscal policy instrument on aggregate consumption.

Unit root tests

TABLE 1: Unit root tests

Variable	ADF			PP		
	Level	First Difference	I(d)	Level	First Difference	I(d)
Ln(CON)	-0.122048	-4.845257*	I(1)	-0.150602	-4.840964*	I(1)
Ln(GE)	-2.324601	-7.588945*	I(1)	-1.200989	-6.904757*	I(1)
Ln(TX)	-1.084064	-5.232123*	I(1)	-0.705084	-5.232123*	I(1)
Ln(YD)	-0.072758	-5.498104*	I(1)	-0.072758	-5.492938*	I(1)

* implies that the series are stationary at the 5% level of significance using both ADF and PP tests. ADF and PP represent Augmented Dickey-Fuller, and Phillips-Perron, respectively.

The results of the unit root test for the stationarity properties of the variables using the Augmented Dickey Fuller (ADF) and Phillips-Perron (PP) tests are reported in table 3.1. The results of the unit root test revealed that all the variables were stationary after the first difference and hence were integrated of order I(1). Thus, the null hypothesis of no unit root cannot be rejected at five percent level of significance.

Lag length selection criteria

For the sensitivity of Johansen cointegration test to the choice of lag length, it is imperative to conduct a series of nested likelihood ratio tests on level VARs to determine the optimal lag length (p) prior to performing cointegration tests. The lag length selection criteria are depicted in Table 2

TABLE 2: VAR Lag Order Selection Criteria

Lag	LR	FPE	AIC	SC	HQ
0	NA	7.20e-06	5.185290	5.454647	5.277148
1	326.6918*	3.45e-10*	-4.796760*	-2.911256*	-4.153749*
2	28.11210	9.27e-10	-4.017785	-0.516134	-2.823622

* indicates lag order selected by the criterion

LR: sequential modified LR test statistic (each test at 5% level)

FPE: Final prediction error

AIC: Akaike information criterion

SC: Schwarz information criterion

HQ: Hannan-Quinn information criterion

Thus, the VAR lag order selection criteria results as represented in Table 3.2 above, show that all the lag selection criteria with the exception of Schwarz Information (SC) indicate two lags. To this end, the study utilized an optimal lag length of one based on the Schwarz Information (SC) criterion. Having selected the lag length, we proceeded to test the long-run equilibrium relationship using the multivariate Johansen-Juselius cointegration test and also estimated the over-parameterized model and the parsimonious model based on this lag length selected.

Cointegration Test

TABLE 3a: Trace test

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.677518	88.33718	69.81889	0.0008
At most 1 *	0.474139	50.99083	47.85613	0.0246
At most 2	0.408607	29.78111	29.79707	0.0502
At most 3	0.205189	12.44705	15.49471	0.1367
At most 4 *	0.137166	4.868580	3.841466	0.0273

Trace test indicates 2 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

TABLE 3b: Maximum Eigenvalue Test

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.677518	37.34635	33.87687	0.0185
At most 1	0.474139	21.20971	27.58434	0.2637
At most 2	0.408607	17.33407	21.13162	0.1568
At most 3	0.205189	7.578466	14.26460	0.4232
At most 4 *	0.137166	4.868580	3.841466	0.0273

Max-eigenvalue test indicates 1 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

The test results of the trace test indicate that there are two cointegrating vectors at the five percent levels of significance. Following the decision rule for the Johansen cointegration tests, we reject the null hypothesis of no cointegration and accept the alternative hypothesis of cointegration in the variables at this five percent level of significance. Since there are at most two cointegrating vectors and two linear combinations of the variables that are stationary then all other linear combinations are non-stationary. The results therefore suggest the presence of cointegration in the time series variables implying that the normalized cointegrating coefficient gives the long-run relationship in the variables.

Unlike the trace test, the maximum Eigen value statistic in table 3.4b indicates one cointegrating equation at the five percent level of significance. This is because the Max- Eigen statistic value computed is greater than the critical value at the five percent level of significance. Hence, the conclusion is that there exists a long-run relationship amongst the variables in the model.

TABLE 4: Parsimonious results

Dependent Variable: DLCONS(ACONS)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.075427	0.040998	1.839748	0.0773
DLCONS(-1)	0.397602	0.143912	2.762817	0.0104
DLYD	0.339567	0.116250	2.920998	0.0071
DLYD(-1)	-0.452046	0.152680	-2.960741	0.0065
DLGE	0.366176	0.103301	3.544749	0.0015
DLGE(-1)	0.216332	0.102861	2.103148	0.0453
DLTX	-0.147806	0.059587	-2.480512	0.0199
ECM2(-1)	-0.961157	0.162166	-5.926991	0.0000
R-squared	0.710190	Mean dependent var		0.228968
Adjusted R-squared	0.632164	S.D. dependent var		0.182519
S.E. of regression	0.110697	Akaike info criterion		-1.361719
Sum squared resid	0.318599	Schwarz criterion		-1.002575
Log likelihood	31.14921	Hannan-Quinn criter.		-1.239240
F-statistic	9.101985	Durbin-Watson stat		2.000562
Prob(F-statistic)	0.000012			

Parsimonious Result

The results of the parsimonious specification of the impact of fiscal policy instrument on aggregate consumption in Nigeria are depicted in table 4 above. The error correction variable has the correct negative sign and was statistically significant in conformity with theoretical expectation. The coefficient of the error correction variable 0.961 showed that 96 percent of the disequilibrium in the consumption- fiscal policy equation was corrected each year. This is a fast speed of adjustment from short run disequilibrium to long run equilibrium.

Analysis showed that one period lagged value of consumption has a positive impact on the current value of consumption. This outcome is consistent with a priori expectation, indicating that a one percent increase in the one period lagged value of consumption led to an increase in the current value of consumption by 0.39 percent. The variable was also statistically significant at 5 percent level of significance. This is because its p-value of 0.01 was less than the critical p-value of 0.05 at five percent level of significance.

Similarly, the result showed that disposable income has a significant positive impact on consumption in Nigeria. The result is in line with a priori expectation showing that a one percent increase in disposable income led to an increase in consumption by 0.33 percent, *ceteris paribus*. The variable was also statistically significant in influencing consumption in Nigeria. This is because its p-value of 0.007 is less than the critical p-value of 0.05 at five percent level of significance. On the other hand, one period lagged value of disposable income exerted a significant negative relationship with consumption in Nigeria. In real term, a one percent increase in the one period lagged value of disposable income led to a decrease in current consumption by 0.45 percent. The variable was statistically significant in influencing consumption as its p-value of 0.006 is less than the critical p-value of 0.05 at five percent level of significance.

In line with theoretical expectation, government expenditure and one period lagged value of government expenditure exhibited a significant positive relationship with consumption in Nigeria during the evaluation period. In real term, the result showed that a one percent increase in government expenditure and one period lagged value of government expenditure led to an increase in consumption by 0.36 and 0.21 percent respectively. The variables were also statistically significant. This is because their p-values of 0.001 and 0.04 were less than the critical p-value of 0.05 at five percent level of significance.

In line with a priori expectation, level of taxation has a significant negative impact on consumption in Nigeria. This means in real term that a one percent increase in the level of taxation led to a decline in consumption by 0.14 percent, other factors remaining the same. The variable was also statistically significant because its p-value of 0.01 was less than the critical p-value of 0.05 at five percent level of significance.

Given the R-squared of 0.710 and the adjusted R-squared of 0.632 showed that the estimated outcome demonstrated a moderately high explanatory power. For instance, the adjusted R-squared of 0.632 showed that approximately 63 percent of the deviation in the dependent variables was accounted for by the independent variables. The model has a good fit. The F-statistic value calculated of 9.101 was greater than the tabulated f-statistics value of 2.09 at five percent level of significance. This result implies that the overall model was statistically significant. This also means that the independent variables have joint effect on the dependent variable during the evaluation period. The Durbin-Watson statistics of 2.000 showed that there is no autocorrelation among the residual terms in the model hence the model is well specified and findings can be utilized for the prescription of policies in the Nigerian economy.

Conclusion and Recommendation

The summary of the outcome of the various estimations is presented as follows.

The positive and significant impact of government expenditure on consumption spending calls for the government of Nigeria to increase its expenditure on socio-economic activities in Nigeria. In particular, the government should increase spending on critical infrastructures such as electricity, transportation, communication, education, skill development, health etc. Also, the government should increase its spending on social security and transfer payments as such spending increase consumption expenditure of individuals.

Meanwhile, the negative and significant impacts of personal income tax on consumption calls for reduction in the personal income tax rate in Nigeria. The tax policy should be progressive, a situation where individuals with low income pay smaller amount of tax while those with high income pay higher amount of tax.

The positive and significant impact of disposable income on consumption calls for the increase in income in Nigeria to support consumption expenditure. The current N18,000 minimum wage rate is grossly inadequate to support reasonable consumption, given the recessionary condition experienced currently in Nigeria. To this end, the minimum wage should be increased for the low-income earners so as to increase their consumption expenditures.

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