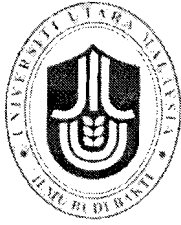


**EFFECT OF CAPITAL EXPENDITURE ON SOCIO – ECONOMIC
DEVELOPMENT OF LIBYA FROM 1970 TO 2005**

**A master Thesis submitted to the College of Business Universiti Utara Malaysia
in partial fulfillment of the requirements for the degree of
Master of Economics**

**By
FATMA T. ELGADI ALJETLAWI**

© FATMA T. ELGADI, 2012. All rights reserved.



Othman Yeop Abdullah
Graduate School of Business

Universiti Utara Malaysia

PERAKUAN KERJA KERTAS PROJEK
(Certification of Project Paper)

Saya, mengaku bertandatangan, memperakukan bahawa
(I, the undersigned, certified that)

FATMA T. ELGADI ALJETLAWI (807766)

Calon untuk Ijazah Sarjana
(Candidate for the degree of) **MASTER OF ECONOMICS**

telah mengemukakan kertas projek yang bertajuk
(has presented his/her project paper of the following title)

**EFFECT OF CAPITAL EXPENDITURE ON SOCIO-ECONOMIC
DEVELOPMENT OF LIBYA**

Seperti yang tercatat di muka surat tajuk dan kulit kertas projek
(as it appears on the title page and front cover of the project paper)

Bahawa kertas projek tersebut boleh diterima dari segi bentuk serta kandungan dan meliputi bidang ilmu dengan memuaskan.

(that the project paper acceptable in the form and content and that a satisfactory knowledge of the field is covered by the project paper).

Nama Penyelia : **DR. LIM HOCK EAM**
(Name of Supervisor)

Tandatangan :
(Signature)

DR LIM HOCK EAM
Senior Lecturer
School of Economics, Finance and Banking
UUM College of Business
Universiti Utara Malaysia

Tarikh : **02 JANUARY 2012**
(Date)

PERMISSION TO USE

In presenting this thesis in partial fulfillment of the requirements for a postgraduate degree from Universiti Utara Malaysia, I agree that the University Library may make it freely available for inspection. I further agree that permission for copying of this thesis in any manner, in whole or in part, for scholarly purpose may be granted by my supervisor(s) or, in their absence by the Dean of Postgraduate Studies and Research. It is understood that any copying or publication or use of this thesis or parts thereof for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to Universiti Utara Malaysia for any scholarly use which may be made of any material from my thesis.

Requests for permission to copy or to make other use of materials in this thesis, in whole or in part, should be addressed to

**Dean
Othman Yeop Abdullah Graduate
School of Business
Universiti Utara Malaysia
06010 UUM Sintok
Kedah Darul Aman.**

ABSTRACT

The effects of government expenditure and its size have stimulated controversy in macro economics in recent time especially on a long run economic growth. Public expenditure policies respecting sound government finances are key to fostering growth and preserving macroeconomic stability because public expenditure supports growth via public services. Libyan government expenditure has been on the increase for some time now. The problem is how effective (in terms of stimulating economic growth) are the government expenditure and what are the causes of this increasing government expenditure.

This paper is based on an economic analysis of Libya's capital expenditure on socio economic development during the period 1970-2005. In addition, the research is aimed at finding the causes of the increase in Libya's government expenditure from 1970 to 2005 and what is going to be the impact of such increase on the economic growth.

The data is sourced from annual report of Central Bank of Libya from the period of 1970-2005. In addition, to estimate the effect of government expenditure on economic growth, the Error Correction and Granger Causality Model are estimated (for effect of economic growth on government expenditure as well). The findings indicate that no consistent evidence that changes in government spending has an impact on per capita real output growth. The flow of causality seems to be running in the other direction from output growth to government spending. Therefore, an important implication of the analysis for the conduct of public policy in Libya is that the government can face its deficit by shrinking its size and limiting its role in the economy.

ACKNOWLEDGEMENT

By the Name of Allah, the Most Gracious and the Most Merciful

Praise to Allah for his guidance and blessing for giving me the strength and perseverance to complete this project. I would foremost like to thank my husband and my parents, for providing me with the opportunity to pursue my goals and for their love and affection, which has helped me through the most trying times. Equal gratitude goes out to my siblings and brothers. I would like to thank my supervisor: Associate **Dr. Lim Hock Eam** for his guidance and constant motivation that has enabled me to complete my project work. Moreover, I would also like to thank him for the opportunities that he has made available to me.

Many thanks go to my evaluator **Dr. Hussin Abdullah** for his tremendous help in providing me the valuable support; time and feedback are much appreciated.

May God bless you all.

FATMA T. ELGADE

1, January, 2012

TABLE OF CONTENTS

PERMISSION TO USE	i
ABSTRACT	ii
ACKNOWLEDGEMENT	iii
TABLE OF CONTENTS	iv
LIST OF TABLE	vi
LIST OF FIGURES	vii
CHAPTER ONE: INTRODUCTION	
1.0 The Libyan Economy	1
1.1 Government Expenditure and Economic Growth.....	5
1.2 Statement of the problem and Research question.	7
1.3 Objectives of the study	8
1.4 Research methods.....	8
1.5 Significant of the study	9
1.6 Scope of the study	10
1.7 Organization of the study	10
CHAPTER TWO: LITERATURE REVIEW	
2.0 Government Expenditure	11
2.1 The Trend of public Expenditure Development in Libya from 1970 to 2009	14
2.2 Factors Influencing Government Expenditure.....	19
2.3 Effects of Government Expenditure on Economic Growth.....	21
2.4 Conclusion.....	22
CHAPTER THREE: DATA AND METHOTOLOGY	
3.0 Data	23

3.1 Methodology	24
3.2 Conclusion	27
CHAPTER FOUR: ESTIMATION RESULTS: GOVERNMENT EXPENDITURE AND ECONOMIC GROWTH	
4.0 Introduction	28
4.1 Government Expenditure.....	28
4.2 Economic Growth	34
CHAPTER FIVE: DISCUSSIONS	
5.0 Introduction.....	37
5.1 Negative Effect of Government Expenditure and Economic Growth.....	37
5.2 Political and Economic Context of the effect of Public Expenditure on Economic Growth..	39
CHAPTER SIX: CONCLUSION	
6.0 Conclusion.....	43
References	45

LIST OF TABLES

Table 1.1:	GDP, Imports, and the Structure of Imports (Libya, selected years).....	3
Table 1.2:	GDP, Imports, and the Structure of Imports (Libya, selected years).....	4
Table 4.1:	Unit root test.....	30
Table 4.2:	Johansen cointegration test for Libya's Government Expenditure (1970-2005)....	31
Table 4.3:	Granger Causality Test	32
Table 4.4:	Granger and ECM Estimates.....	33
Table 4.5:	How Government Expenditure affects Economic Growth.....	35

LIST OF FIGURES

Figure 5.1: Real GDP growth rate averaged 7.5 percent per year between 2005 and 2007....	40
Figure 5.2: Economic Performance.....	41

CHAPTER ONE

INTRODUCTION

1.0 The Libyan Economy

The Libyan economy is characterized by high degree of interdependence with the rest of the world, particularly in the field of trade exchange. As such, the country is heavily reliant on the exports of crude oil, as the main source of foreign exchange earnings (Wilkinson, 2002). However, like the typical oil-rich countries in the Middle East and North Africa (MENA) region, Libya has until recently relied heavily on oil exports. With widely fluctuating and generally declining oil prices and revenues in the last two decades, the country has since 1970s exerted notable efforts aimed at achieving economic diversification. These efforts have led to sustained investment in the non-oil sectors, especially in manufacturing, agriculture and other sectors of the economy (USA Department of Commerce, 1997).

However, the main objective of economic development plans in Libya is to diversify the local economy and to find other sources of income rather than oil to achieve such growth in non-oil sector, capital goods imports and raw materials may play a crucial role in the economic development process, as a means of sustaining the country's economic development plans. To be able to effectively estimate the effect of the expenditure of government there is need for the assessment of the relationship between import and economic growth and GDP and import.

Libya is one of the developing countries with large area and low density of population and large endowment of natural resources, oil and gas. It relies heavily on a single exportable

The contents of
the thesis is for
internal user
only

REFERENCES

- Abdullah HA, (2000) The Relationship between Government Expenditure and Economic Growth in Saudi Arabia. *Journal of Administrative Science*, 12(2): 173-191.
- Abu-Bader S, Abu-Qarn AS, 2003. Government Expenditures, Military Spending and Economic Growth: Causality Evidence from Egypt, Israel, and Syria. *Journal of Policy Modeling*, 25(6-7): 567-583.
- Afonso, A. and Gomes P. (2008), "Some Determinants of Public and Private Sector Wages", Mimeo: ECB.
- Ahlbrandt, T. (2001) Sirte Basin Province: Sirte- Zelten Total Petroleum System USGS
- Akanni, I. (2011) Foreign Aid, Public Expenditure and Economic Growth: The Nigerian Case. *Journal of Applied Business Research* Vol 27, No 3
- Al-Yousif Y. (2000) Does Government Expenditure Inhibit or Promote Economic Growth: Some Empirical Evidence from Saudi Arabia. *Indian Economic Journal*, 48 (2).
[<http://www.sciencedirect.com/science/journal/01618938>] retrieved November 11th 2011
- Barro, R.J (1990) Government spending in Simple model of endogenous growth. *The journal of political economy* 98 (5) part 2: 3103- 5124
- Bryman, A. (2004), "*Social Research Method*", 2nd Ed, Oxford University Press, New York.
- Central Bank of Libya, *annual reports*, 1995-2005, various issues, Tripoli, Libya.
- Central Bank of Libya Economic Bulletin (2000) Socialist People's Libyan Arab Jamahiriya
- Devarajan , S.,Swaroop, V. and Zuo, H. (1996) the composition of Public expenditure and economic growth. *Journal of monetary economics* Vol. 37 (2):313-344
- Dickey, D.E. and Fuller, W.A (1979). Fiscal policy and growth in the Middle East and North Africa regions. IMF working paper WP/97/101
- Dolado J.J., Gonzalo, J., and Marmol F, (1999) *Cointegration*. Department of Economic, Statistics and Econometrics, University Carlos III de Madrid, Spain.
- Dutta and Nasiruddin, A, (1986) *An aggregate import demand function for Bangladesh: A cointegration Approach*. Department of Economics, University of Sydney, Australia,

Energy Information Administration (2007) *Country Analysis Brief* :Libya.

El-Saharty, S., G. Richardson, and S. Chase. 2005. Egypt and the Millennium Development Goals: Challenges and opportunities. World Bank Health, Nutrition, and Population Discussion Paper. Washington, D.C.

Engle, R.F. and C.W.J. Granger, (1987) Co integration and error correction: representation, Estimation and testing

Fan, S., and Saurkar A. (2008) “Public Spending in Developing Countries: Trends, Determination, and Impact In Public Expenditures, Growth, and Poverty: Lessons from Developing Countries. Johns Hopkins University Press for the International Food Policy Research Institute

Granger, C.W.J. (1969) Investigating Causal relations by econometric models: cross spectral methods *Econometrical* 37 (3):424-438

Griffin, K and T. McKinley (1992). Towards a Human Development Strategy, *Occasional Paper* 6, December

IFPR (2006), a multilevel analysis of public spending, growth and poverty reduction in Egypt: Development strategy and governance division.

Kelly, T. (1997). “Public Expenditures and Growth” *Journal of Development Studies* 34: 60-84.

Mark, S. McGuire, T. and Leslie P. (2000) “The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area,” *National Tax Journal* 53 No. 1 : 105-124.

Martin, L., and Paul, V. (2006) EU: Causes of Growth differentials in Europe A Tax Policy for Growth and Jobs (online) <http://workforall.net> retrieved on November 10th 2011

Mitchell J.D (2005). The Impact of Government Spending on Economic Growth. Backgrounder, 1831. [www.heritage.org/research/budget/bg1831.cfm]

Mobbs P. (2002). *Mineral Industry. Libya.*

Nurudeen, A. Abdullahi U. (2010) Government Expenditure and Economic Growth in Nigeria, 1970-2008: A Disaggregated Analysis Department of Economics, University of Abuja, PMB 117, Nigeria Business and Economics Journal, Volume: BEJ-4

- Osterwald-Lenum, M., (1992), "A Note with Quantiles of the Asymptotic Distribution of the Maximum Likelihood Cointegration Rank Test Statistics," *Oxford Bulletin of Economics and Statistics*, 54, pp.461-472.
- Pilat, D. (2000) Innovation and productivity in Services- State of the Art, Organization, Economic Cooperation and Development, Directorate for science, Technology and Industry, Paris
- Rahuma A. (1989)*Cost of barley and wheat production in some state managed agricultural projects*. J. Agric. Res.
- Ramanathan, R. (1992). *Introductory Econometrics with Applications*, Second Edition. Harcourt New York, Brace Jovanovich.
- Ranjan KD, Sharma C(2008) Government Expenditure and Economic Growth: Evidence from India. The ICFAI University Journal of Public Finance, 6(3): 60-69. [<http://ssrn.com/abstract=1216242>] retrieved on October, 28th 2011
- Shenggen F, Xiaobo Z, and Neetha R, (2004). *Public Expenditure, Growth, and Poverty Reduction in Rural*, Uganda.
- Suleiman A.B and Aamer S. A (2003) Government expenditures, military spending and economic growth: Causality evidence from Egypt, Israel and Syria. Department of Economics, Ben-Gurion University of Nager, Beer-Shera Israel
- UNDP (United Nations Development Programme). 2004. Egypt human development report. New York.
- World Bank 2003. *World development indicators 2003*. Washington, D.C. CD-ROM.
- USA Department of Commerce (1997) Libya, Export Control Program, Description and Licensing Policy, Section 746.4
- Wilkinson, B., (2002) *Establishing a Presence*, in Marat Terterov and Jonathan Wallace, doing business with Libya, P.57.
- World Bank (2006) Tracking Basic expenditures in Yemen: Analyses of Public resource management and Teacher Absenteeism. Social Economic Development Group, Middle East and North African region