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An Investigation of the Relationship between Government Expenditure and Revenue in a Multicurrency Economy: A Case of Zimbabwe

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Abstract
This study investigated the nature of the relationship between government expenditure and revenue for Zimbabwe for the Multicurrency period using monthly time series data covering the period 2010 to 2012. Data was analysed using Granger (1969) causality tests and Cointergration analysis. The results from this study show that there is independence between government expenditure and government revenue hence providing evidence in support of the Institutional Seperation Hypothesis propounded by Wildasky (1988) and Baghestani and MacNown (1994). Hence policies to curb the budget deficit in Zimbabwe should be directed to other factors like economic growth which affect government expenditure and revenues.
Keywords: causality, government expenditure, government revenue, Granger

1. Introduction

Analysis of the causal relationship between government expenditure and revenue has received considerate attention in recent years. This is probably due to ever occurring budget deficits especially for most developing countries where government expenditure is the major tool for spearheading economic development. The Keynesians have always subscribed to the use of government expenditures in maintaining macroeconomic stability. However excessive government expenditures in most developing countries have led to high, unsustainable budget deficits. Because of this trend, studies have been conducted to try and understand the nature of the relationship between government expenditures and its revenues so as to develop appropriate policies meant to reduce these budget deficits.

For Zimbabwe, government deficits ranged between 49% and 70% of GDP for the period 2005 to 2012. These figures went as high as 88% and 91% for 2008 and 2009 respectively (World Economic Outlook October 2012). However, according to ZIMSTATS (2010-2012), the country has actually been experiencing budget surpluses that amounted to approximately US$329million, US$25 million and US$982 000 for the period 2010 to 2012. These figures indicate a sharply declining trend in surpluses for the country though. This might be probably due to that the government of Zimbabwe has been relying on tax revenue to finance its expenditures in light of the loss of borrowing rights from Multilateral Organizations as well as the drying up of foreign aid. Evidence from ZIMSTATS (2009-2012) showed that domestic financing was the only contributor to total financing with nothing coming from foreign financing. In 2009, total revenue amounted to approximately US$934million of which US$882 million was tax revenue (ZIMSTATS 2009). A closer look at Figure 1 shows that tax revenue contributed 92% of total revenue for the period January to June 2009.

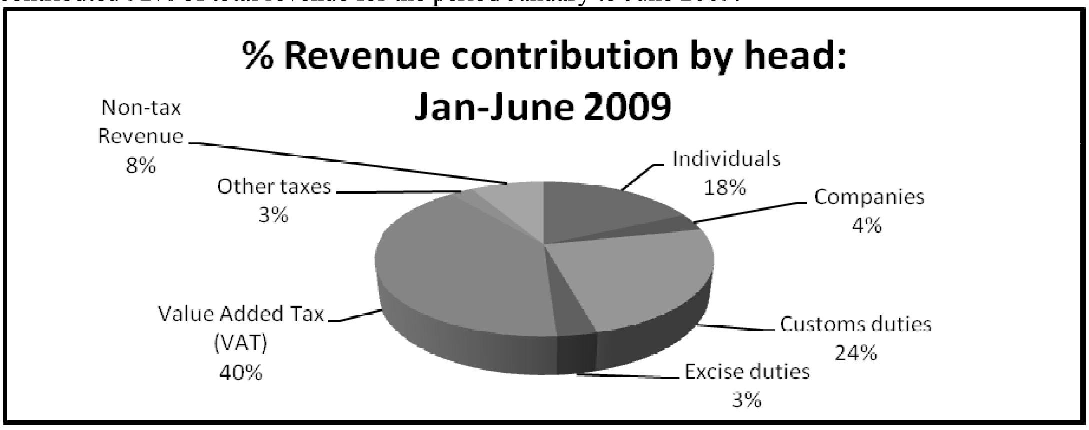

Figure1: Percentage Revenue Contribution for Zimbabwe by Head: Jan-June 2009
Source: ZIMSTATS (2009)

Figure 1 shows the percent contribution of the major revenue heads for the first half of 2009. Value added tax