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An Evaluation of Budget Deficit on Economic Growth in Nigeria: Empirical Evidence

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Abstract
This study evaluates the effect of budget deficit on economic growth in Nigeria from 1985 – 2020. The data used for the study were obtained from Central Bank of Nigeria Statistical Bulletin, Annual Report and publications of the National Bureau of Statistics (NBS). The study applied the Augmented Dickey Fuller (ADF) Unit root and Autoregressive Distributed Lag (ARDL) co-integration and Granger Causality Test. The results revealed that Government Budget Deficit (GBD) has negative and insignificant impact on economic growth; inflation rate (INFL) has positive and insignificant impact on economic growth while government expenditure (GEX) has positive and significant impact on economic growth in Nigeria during the period under study. The R^2 = 0.97, implying 97% change in economic growth was explained by budget deficit. The empirical finding however, demonstrated that budget deficit has negative effect on inflation and economic growth. The study therefore recommends that fiscal discipline should be strongly adhered to at every level of government since inflation has been established as monetary phenomenon in Nigeria. Based on the study findings, government of this country should pursue policies capable of reducing the size of informal sector which have imposed greater constraint to revenue collection and generation.

Keywords: Budget Deficit, Government Expenditure, Economic Growth
JEL Classification: E12, E6, H61, H62

1. Introduction

The development of budget deficit often traced to the Keynesian-Inspired expenditure led growth theory of the 1970s. Most countries of the world adopted this theory that government has to induce the aggregate demand side of the economy in order to stimulate economic growth. However, the consequences of budget deficit on macroeconomic variables cannot be underestimated in most countries of the world. In Nigeria, fiscal deficit have been blamed for much of the economic crisis

that beset them in 1980; over-indebtedness, high inflation, poor investment performance and economic growth. Attempt to regain stability at the macro level through fiscal adjustment achieved uneven success, raising questions about the macroeconomic consequences of budget deficits and fiscal deterioration, in Nigeria (Udionye & Uma, 2013).

Budgeting is a political process that may be influenced by economic consideration; budgeting decision involve two phases namely; expenditure and revenue side, the revenue side take care of what resources the government should take from the individual or private sector in the form of taxation. While expenditure side take care of how government should allocate her resources among its public sector. Budget deficit occurred where public expenditure is greater than public revenue. On the other hand, budget surplus occurred when public revenue is greater than public expenditure. Budget deficit arise as a result of deliberate gap between public revenue and public expenditure and such gaps can be financed by borrowing. Deliberate gap existed with intention of creating economic activity in Nigeria. Politicians of various ideologies argue that deficit reduction is critical to the future of the Nigerian economy. Although, many economists share the view that deficit are harmful and perhaps even disastrous, they cite concern over reason thus; despite almost unanimous concern over deficits, there is considerable controversy about what effects does budget deficit have on the growing economy.

The growth of government deficits after the civil war in 1970 to the introduction of Structural Adjustment Programmed (SAP) in 1986 was attributed partly to post war reconstruction. It was also due to the fact that the government exercised a lot of influence over economic activities and fiscal deficits remained a prominent instrument. Although the persistent deficits were perceived to have adverse effects on the macro economy, the various governments continued to stimulate the economy through deficit spending. In 1986, the government introduced SAP with the hope of restructuring of the economy; there would be reduction in the deficit spending. But it appears not to have been achieved as the deficit continues to escalate on yearly basis. Oladipo and Akinbola (2011) have it that deficit spending of government has posed challenges to the Nigerian economy with regards to its effectiveness and debt accumulation. Paiko (2012) expressed a similar view that excessive and prolonged deficit spending may negate the attainment of macroeconomic stability and distort growth.

The issue of budget deficit has become a recurring decimal due to inconsistency in both fiscal and monetary policy in Nigeria. Whereas, a decline in government revenue, largely due to fall in oil price, this

leads to both foreign and domestic borrowing, the economy is however characterized by increase poverty, constant fall in standard of living, depleting foreign reserve, unfavourable balance of payments, increase debt, over importation, little export, uncontrollable inflationary pressure and over dependence on external bodies (Obioma, 1998). Unfortunately, the budgetary process in Nigeria is said to be fraught with imperfections and abuses. Such abuses manifest in the form of unsustainable and unjustifiable extra budgetary expenditure actuated by obvious disregards or budget indiscipline among others (Olaoye, 2010). The major interest of this research is the impact of budget deficit on economic growth in Nigeria. The study covered the period of 37 years. However, the choice of this period 1981 was basically as a result of the drastic decline in crude oil export earnings in 1981 which led to deficit and financed by borrowing after drastically reducing the nation reserves. Due to unavailability and enough data to capture the current condition of deficit financing in Nigeria, this study will strictly focus on secondary data of budget deficit in Nigeria. Also this study will consider the range of years the federal government experience budget deficit.

However, seeking answers to the following questions becomes necessary: Does total government expenditure impacted the rate of economic growth in Nigeria? Does budget deficit exhibit negative implication on economic growth? What are the causal link between budget deficit and economic growth in Nigeria? Does inflationary rate have an impact on economic growth in Nigeria? This study thus aims to evaluate the effects of budget deficit on economic growth in Nigeria. The study will cover the period of 1985 to 2020 which incorporates the effect of SAP period.

2. Literature Review

2.1 Conceptual Review

Government experience deficit whenever its revenue falls short of its expenditures. In other to obtain the funds necessary to cover the deficit, the treasury or finance ministry must borrow either from internal or external source. Deficit finance is an economic state in which government spending is more than earnings, hence ventures into borrowing. Budget deficit is when the expected government expenditure outweighs the anticipated government revenue within a fiscal year (Obadan, 2011).

Anyanwu (1997) defined budget deficit as a situation where government expenditure exceeds government revenue over a given period of time. When a deficit is involved, it is important to find remedy for financing such deficits so as to eradicate its negative effects. In Nigeria, fiscal deficits have been blamed for much of the economic crisis

that beset them about two decades ago resulting in over indebtedness, high inflation, poor investment performance and growth (Ezeabasili, Mojekwu & Herbert, 2012).

2.2 Empirical Review

The study of the relationship between budget deficit and economic growth is not a new phenomenon in economics literature and it has received a lot of attention in recent times. Wosowei, (2013) attempted to determine the relationship between fiscal deficits and macroeconomic aggregates in Nigeria, employing Ordinary Least Square (OLS)/Causality test, he found that fiscal deficits did not significantly affect macroeconomic output.

Mahauty (2012) examined the impact of fiscal deficit and economic growth in India using vector error correction model. The finding showed a negative but significant relationship between fiscal deficit and economic growth, hence granger causality test shows no causal relationship between fiscal deficit and economic growth in India.

Omoke and Oruka (2010) employed pairwise Granger Causality to test the causal relationship between budget deficit, growth and inflation in Nigeria. The finding showed that both budget deficit and inflation could be caused by money supply, meaning that they are both monetary phenomena, on the other hand, inflation found to be dependent on the performance of the budget. Error correction model and other test of significances were not conducted to determine reliability and conform to the assumption of Best Linear Unbiased Estimator (BLUE).

Adeleke and Abdulsalam (2016) examined the impact of budget deficit on Nigeria's economic growth between 1983 and 2014. Ordinary least square method of regression analysis was employed to determine the long-run relationship among the variables. The ADF result shows that all the variables were stationary and co-integrated at level. It also showed that there is a significant relationship between the deficit budget and inflation as well as money supply and inflation, and recommended that government should display a high sense of transparency in fiscal operations to bring about realistic fiscal deficit.

Sanya and Lawal (2016) examined the impact of fiscal deficit on the growth of Nigeria economy using co-integration and error correction model, there result showed that there exist a stable long-run relationship between economic growth and budgeting components (current and capital expenditure). They also argued that deficit budget is one of the indicators of macroeconomic instability and significantly discourage human capital accumulation.

Kurantin (2017) utilized a panel data set between 1994 and 2014 to examine the effects of budget deficit on economic growth in Ghana.

The study evaluates the Ghanaian experience on fiscal deficit and its implications on sustainable growth and development. Using an OLS technique to run the estimation findings reveals that budget deficit has a negative effect on economic growth while investment shows a positive impact on economic growth.

Arjomand, Emami and Salami (2016) examined the role of budget deficit in ten selected countries within the Middle East and North Africa (MENA) region with particular emphasis on its effects on growth and productivity. The paper utilized the Estimated Generalized Least Square (EGLS) technique on a panel data covering the period of 2000 to 2013 using two different models. Model one used budget deficit as the dependent variable while the second model employed economic growth as the regress and the overall result shows that the existence of negative relationship between labour productivity and deficit in the first model. Inflationary rate results revealed negative relationship on Real – GDP, indicating that a part of the major cause inflationary pressure in Nigeria has been the abuse of budget deficit. This is in line with the work of Fihiman (2015), the study examined the impact of budget deficit on economic growth in North Cyprus. The finding shows that inflationary rate and budget deficit has negative and insignificant impact on economic growth. Though, in the period of high inflation, government can still adopt budget deficit which in turn, fuelled inflation.

Ezeabasili, Tsegba and Wilson (2012) studied economic growth and fiscal deficits: empirical evidence from Nigeria. The study adopted a modeling technique that incorporates cointegration and structural analysis. The results indicate that fiscal deficit affects economic growth negatively, with an adjustment lag in the system; a one percent increase in fiscal deficit is capable of diminishing economic growth by about 0.023 percent; and here is a strong negative association between government consumption expenditure and economic growth.

Sulaiman and Azeez (2012) studied the effect of external debt on the economic growth of Nigeria using gross domestic product as the endogenous variable measuring economic growth as function of ratio of external debt to export, inflation and exchange rate proxy as the exogenous variable. Data were gathered covering 1970-2010. Analysis of date was done using the econometric technique of ordinary least square. The result showed that external debt has contributed positively to Nigeria economy. A similar research was done by Iya, Gabdo, and Aminu (2013) with the same result.

Ogege and Ekpudu (2010) examined the impact of debt burden on the Nigerian economy using time series data from 1970-2007. Ordinary least square (OLS) was used to test the relationship between debt burden and growth of the Nigeria economy. The result showed

a negative relationship between debt stock of internal and external; and gross domestic product, meaning that an increase in debt stock will lead to a reduction on the growth rate of Nigerian economy.

Liu, Hsu and Younis (2008) carried out a study on the Association between Government Expenditure and Economic growth: The Granger causality test of the US data, 1974–2002. This paper employs Granger causality test on US federal government data, from 1947 to 2002. We used aggregate data as well as disaggregate data with the sub-categories of five federal expenditures, including: national defense, human resources expenditure, physical resources expenditure, net interest payment, and other expenditure. The results of our study suggest that total federal government expenditure is more consistent with Keynesian's theory while there are diversified causal relationships among five sub-category of federal expenditure. The policy recommendation generated from this paper is that the US federal government should invest more public resources in human resources expenditure assuming that economic growth is the utmost important item on the government agenda.

Okoye and Akenbor (2010) attempted a study on the impact of deficit financing on socioeconomic activities in Nigeria. To achieve this objective research questions were raised, hypotheses were formulated and relevant literatures were reviewed. In gathering the necessary data for the study, various publications of the central bank of Nigeria statistical bulletin of the period 1997 – 2007 were considered. The findings of the study revealed that deficit financing has a positive and insignificant relationship with economic activities but a positive and insignificant relationship with socio/community services. This implies that deficit financing is more tailored towards social development, but lack of finance and frugality in management of funds in Nigeria hinders the realization of this ream. It was therefore recommended that since our political leaders refused to be financially disciplined, deficit financing in Nigeria should be brought to a very low level or worst still, be discouraged irrespective of its political justification.

3. Methodology

The research design for this work is ex-post factor research design. It is a time series study. It covered various aspects of Nigeria's deficit budget from 1985-2020. Secondary data were collected from Central Bank of Nigeria Statistical Bulletins 2013 and World Bank. Data were collected on Nigeria's Gross Domestic Product, External debts, budget deficit, inflation and government expenditure for a period 1985 to 2020. Data were analyzed using Autoregressive Distributed Lag Model.

Diagnostic test to ensure robustness of the work was done using Augmented Dickey Fuller (ADF) unit root test, co integration.

3.1 Model Specification

The model for this research was anchored on Keynesian Theory to support the idea supporting Nigeria's growth policy in Keynes assertion, productive spending depend on how government uses budget spending for economic growth purpose and this could result to budget deficit. But Keynes promoted this theory for developed countries to overcome economic crisis. Based on the objectives of the study, the model used by Emefiele, Obim and Ita (2019) was adopted where gross domestic product was seen as a function of government deficit budget, thus:

$GDP = f(DEFB, INF, GOVEXP) - - - - - - - - - - - - - 1$

Where;

GDP = Gross Domestic Product

DEFB = deficit budget

INF = Inflation rate

GOVEXP = Government expenditure

Therefore the model has been modified to incorporate external debt as one of the variables and the preferred model should be in the following functional forms.

$RGDP = F(GDB, INFL, GEX, EXD) = - - - - - - - - - - - - 2$

$RGDP_t = \alpha_1 + \alpha_2 \text{InGDBt} + \alpha_3 \text{InINFLt} + \alpha_3 \text{InGEXt} + \alpha_4 \text{lnEXDt} + \text{Et} - 3$

Where

$RGDP_t$ = Real Gross Domestic Product of Nigeria which measures Economic Growth within the period of the study

$GDBT_t$ = Government Deficit Budget

$INFL_t$ = Inflation rate

$GOVEXP_t$ = Government expenditure

EXD = External debt

t = Time period chosen for the study 1985 – 2020

ln = Natural log used to bring estimated date for the variable to common base

α = Constant term

α_1, α_2 and $\alpha_{3 \text{ and }} \alpha_4$ = Slope of the independent variables

E_t = Error term in the model 1, this postures other variables that are not mentioned in the model.

4. Results and Discussion

The study employed five variables: Real gross domestic product (RGDP), as dependent variable, while the explanatory variables are: Government deficit budget (GDB), Inflation Rate (INFL) , government expenditure (GEX), and external debt (EXD). The data was sourced from World Bank Report and Central Bank of Nigeria Statistical Bulletin (2020).

Table 1: Correlation Matrix

	RGDP	EXD	GEX	GBD	INFLA
RGDP	1				
EXD	0.1890	1			
GEX	0.9616	0.1021	1		
GBD	0.7838	0.2964	0.7311	1	
INFL	-0.2919	0.3094	-0.3103	-0.2505	1

Source: Authors Computation, 2021

Table 1 shows that there is a strong positive correlation between GBD and RGDP (r = 0.7838), GEX and RGDP also shows a strong positive correlation (r = 0.9615) while INFLA and RGDP shows a weak negative correlation (r= -0.2919). Furthermore, GEX and GBD shows a strong positive correlation (r=0.7311) and there is a weak negative correlation between IFLA and GDB(r = 0.2505) and finally INFLA and GEX shows a weak negative correlation (r = 0.3103). EXD also recorded a positive and weak correlation to RGDP. .

Table 2: Augmented Dickey Fuller (ADF) Unit Root Test Result

Variable	**ADF statistics (1st diff)**	**Critical value 5%**	**Probability Value**	**Order of Stationarity**
RGDP	-7.437559	-2.951125	0.0000	1(1)
GDB	-5.624031	-2.971853	0.0001	1(1)
GEX	-4.342310	-2.951125	0.0016	1(0)
INFLA	-4.514653	-2.960411	0.0011	1(1)
EXD	-4.334567	-2.951125	0.0016	1(1)

Source: Authors Computation, 2021

The result of the unit root test in Table 2 shows that RGDP, GDB and INFL were stationary at first differencing with intercept at 5 percent level of significance that is they all became stationary at first differencing. However, government expenditure was to be stationary at level. Since the results exhibit stationary at first differencing, it is therefore, necessary to carry out co-integration test to ascertain whether

the variables have long-run equilibrium relationship in the model by using the Johansen Co-integration test.

Table 4: Results of the ARDL Bound Test

ARDL Bound Test Level			
F-statistic	Critical values		
	Significance	Lower Bounds I(0)	Upper Bounds I(1)
4.667756	5%	2.86	4.01
	10%	2.45	3.52

Source: Authors Computation, 2021

The null hypothesis of the ARDL bound test is that there is no long relationship (co integration) between the variables. Given that the computed f-statistic (4.7) of the ARDL bounds test is greater than the upper critical value (4.01) at 5% level of significance, the null hypothesis is rejected. This implies that there is co-integration among growth in real gross domestic product as the dependent variable and the independent variables. Hence, we can estimate the short and long run effects of the independent variables on the dependent variable. The result of the long run effects of government expenditure, government budget deficit and inflation rate on economic growth are presented below in table 5.

Table 5: Long run estimates of the ARDL Model

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
EXD	1.043279	0.708587	1.472338	0.1667
GEX	1.604186	0.424166	3.781978	0.0026
GBD	-1.234723	0.960713	-1.285215	0.2230
INFL	1.487268	1.005751	1.478764	0.1650
C	-15.387226	16.592931	-0.927336	0.3720

Source: Authors Computation, 2021

From the results of the long run estimated coefficients and using the lag length of (1, 3, 3, 4, 4), the results indicated that only government expenditure is statistically significant. However, the coefficient has a positive sign. The results show that holding other variables constant, a 1% increase in government expenditure will yield a 1.6% increase in real GDP. On the other hand, if all things remain the same, a 1% rise in government deficit budget would cause a reduction in real GDP equal to 1.71. That is a negative and weak relationship exists between government deficit budget and real GDP. This result nullifies the a priori

expectation of a positive relationship between government deficit budget and real GDP.

Inflation rate and external debt revealed a positive and insignificant relationship with real GDP and contrary to the expected sign of positive and negative signs respectively. The value of the intercept (-15.4) which is the predicted value of real GDP assuming all the independent variables are equal to zero and is statistically significant at 5% level.

Table 6: Results of the Short run Estimation

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
D(EXD)	-0.031002	0.621835	-0.049855	0.9611
D(GEX)	-3.205640	1.505861	-2.128776	0.0547
D(GBD)	0.037036	0.082766	0.447478	0.6625
D(INFLA)	-0.005787	0.274486	-0.021083	0.9835
CointEq(-1)	-0.634538	0.296541	-2.139802	0.0436

ARDL model econometric criteria: R-squared = 0.974588; Adjusted R-squared = 0.934353; F-statistic =24.22221; Prob (F-statistic) = 0.000000

Source: Authors Computation, 2021

From table 6, the elasticities of output with respect to the independent variables in the short run showed that one variable (GEX) is statistically significant while government deficit budget, external debt and inflation were found to be insignificant. Thus, government budget deficit, external debt and inflation rate do not contribute to economic growth. Nonetheless, the coefficient of the error correction term (ECT) is significant and it has the correct sign. This supports the finding of a stable long run relationship among the variables. Therefore, it can be noted that the system adjust towards long run equilibrium at a high speed of 63.5%.

In addition, the results of the short-run estimates show that government expenditure and inflation rate impedes economic growth in Nigeria and statistically insignificant at the 5% level. Consequently, government budget deficit indicated positive insignificant relationships with economic growth in Nigeria. The R^2 (Coefficient of determination) shows that 97% of the total variation in the dependent variable; economic growth, can be explained by the explanatory variables while only 3% cannot be explained but is captured by the error term. The drop to about 93% after adjusting for degree of freedom is still significant. The F-statistic is approximately 24.22 with probability of 0.000000. The significance of this value implies that the data used in the estimation fitted well into the regression equation, hence the model is adequate in

explaining the impact relationship of the independent variables on real GDP in Nigeria.

Table 7: Granger Causality Test Result

Null hypothesis	Obs	F-statistic	Prob.	Decision
GBD does not Granger Cause RGDP RGDP does not Granger Cause GBD	34	2.90074 6.95102	0.0711 0.0034	GDB⇒RGDP unidirectional causality
GEX does not Granger Cause RGDP RGDP does not Granger Cause GEX	34	2.06830 3.98492	0.1446 0.0296	GEX⇒RGDP unidirectional causality
INFLA does not Granger Cause RGDP RGDP does not Granger Cause INFLA	34	1.10995 4.51395	0.3432 0.0196	IFLA⇒RGDP unidirectional causality
EXD does not Granger Cause RGDP RGDP does not Granger Cause EXD	34	2.90074 6.95102	0.0711 0.0034	EXD⇒RGDP unidirectional causality

Source: Authors Computation, 2021

The causal relationship between RGDP, GEX, GBD and INFLA is the main focus of this empirical investigation. Generally, the Pairwise Granger test helps to determine the direction of causality between the variables in the specified model. The result from Table 7 showed that the p-value of GBD and RGDP are 0.0711 and 0.0034 respectively. Since of the probabilities is less than 0.05 we therefore reject the null hypothesis and accept the alternative hypothesis meaning there is a unidirectional causal relationship between GBD and RGDP and the direction of causality is from RGDP to GBD. The table also showed that there is a unidirectional relationship between GEX and GEX within the period of study. The causality also runs from RGDP to GEX. Consequently, the result showed that there is a unidirectional causal relationship between INFLA and RGDP and the direction of causality is from RGDP to INFLA. EXD and RGDP also shows a unidirectional relationship with each other running from real GDP to inflation.

Table 8: Summary of Results of the Post Diagnostic Tests

Diagnostic tests		
Test	**F-statistic**	**Probability**
Breusch-Godfrey Serial Correlation LM Test	1.657001	0.2390
Heteroskedasticity Test: Breusch-Pagan-Godfrey	0.401420	0.9634
Ramsey RESET Test	1.702509	0.2186

Source: Authors Computation, 2021

For a proper interpretation of results, the results of the ARDL co-integration test was interpreted and evaluated for serial correlation, Heteroskedasticity and stability. From table 8, it can be observed that the probability values for Breusch-Godfrey Serial Correlation LM Test and Breusch-Pagan-Godfrey Heteroskedasticity Test are greater than 0.05, thus the null hypothesis of no serial correlation and Heteroskedasticity were not rejected. Also the probability of value (0.22) of the Ramsey RESET Test for stability is greater than 0.05 hence, we fail to reject the null hypothesis that the model is correctly specified.

5. Conclusion and Recommendations

Budget deficit plays an extraordinary and growing role in achieving full employment, sustainable economic growth, price stability and poverty reduction. Theoretically, both Keynesian and neoclassical economists provided tools for government intervention particularly with regards to government budget deficit financing. The result of the estimation showed a negative and insignificant relationship between budget deficit and Real – GDP. This shows that fiscal deficits are the total debt generated by the government to finance its expenses, indicating that government has no other option than borrowing. When fiscal deficit is high, it implies that government has to borrow heavily, meaning demand for loan will rise in the market leading to higher interest rate and high cost of borrowing. Private firms shy away from loan and pull out from existing projects.

The epistemological justification of the negative relationship between fiscal deficit and economic growth is theoretically underpinned by the Neo-Classical school. This study is in line with the studies by Mahauty (2012) and Kurantin (2017) who found a negative but significant relationship between fiscal deficit and economic growth. However, the study result was in contrast to the one by Okoye and Akenbor (2010) who found that deficit financing has a positive and significant impact on economic activities in Nigeria. The study findings

also showed that there was a unidirectional causal relationship between government deficit budget and economic growth.

The results further revealed that a 1% increase in government expenditure will yield a 1.60% increase in real GDP. In other words, there was a positive and significant relationship between real GDP and government expenditure. However, there was a unidirectional causal relationship from Real GDP to government expenditure within the period of study. This was in line with the study by Liu, Hsu and Younis (2008) who found that GDP causes growth of government expenditure. On the other hand, growth of real GDP causes expansion of government expenditure. The error correction term in the model is highly significant and correctly signed. In specific terms, the result indicates a coefficient of (-0.63 with a P value of (0.04) which is less than (0.05) level of significance. The results of ECM indicate that there is system adjustment from the short disequilibrium to the long run equilibrium. The coefficient is -0.63 meaning that system corrects its previous period disequilibrium at a speed of 63% yearly. Thus the result shows a quick speed of adjustment from short run dynamics to long run steady state

Given the above findings, the study therefore makes the following recommendations are made:

i. In order to achieve high budget deficit, government must increase her borrowing pattern through the use of budget instruments (fiscal policy and monetary policy) to sustain economic growth in Nigeria.

ii. Since deficit financing is negative, government should increase both capital and recurrent expenditure to ensure that funds meant for developmental projects are properly managed.

iii. Policy makers should focus on maintaining inflation at low rate (single digit) and ensuring interest rate stability and this can be achieved with high borrowing pattern.

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