Deficit Budget and Its Effect on the Growth of Nigeria Economy

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Abstract
The study empirically examined deficit budget and its effect on the growth of Nigeria Economy. The specific objectives were; to examine the effect of deficit, inflation and government expenditure on the growth of Nigeria Economy. Secondary sources of data was extracted using statistical bulletin of Central Bank of Nigeria and the adoption of multiple regression analysis. Based on the analysis, the following findings revealed thus; there is no significant relationship between deficit budget and economic growth (GDP); there is no significant relationship between inflation and economic growth (GDP); and there is a significant relationship between government expenditure and economic growth (GDP). The following recommendations were proffered; government should strive to finance budget deficit by improving on the present revenue base rather than resulting to domestic borrowing, this can be achieved by improving its revenue sources and efficient pursuit of tax reforms. Also recommended that effective mechanism should be put in place to ensure that any government spending is judiciously utilized to contribute to economic growth

Keyword: *Deficit budget, inflation, government expenditure, GDP.*

1.0 Introduction

The role of the government as embroiled in its fiscal operation in determining aggregate demand, income, price and more recently, the balance of payments is the outcome of Keynesian economist which came into being after great depression of the 1930's. A major recognition by Keynes is that an economy could converge to a stable equilibrium which may be undesirable, since it might involve some involuntary unemployment and, in the Keynesian model only government has the means through fiscal policy to move the economy towards a regulation of its revenue and expenditures. There has been urgent need for rapid economic development in most developing countries. The need for government to be involved in the process is more pronounced because the question of development cannot be answered without a conscious planning. Although in some of the countries, particularly in Nigeria, the government often tends to pre-occupy itself with the issue of development and the breaking of vicious cycle of poverty (that is low income per capital leading to low saving, leading to low investment and eventually low productivity (Brauniger, 2012).

Deficit budgeting is viewed as a conscious or deliberate plan by government for an excess expenditure over revenue in its budgetary allocation over a long period of time. For instance, between 1985 and 1990, 3.87 percent of deficit to the gross domestic product (GDP), while between 1991 and 1995, 1996 and 2000, 2001 and 2005, 2006 and 2007 are 4.96 percent, 0.16 percent, 2.30 percent and 2.65 percent respectively. (De Haan & Zelhorst, 2010). The country adopted a new planning technique in 1986 which was encapsulated in the policy of structural adjustment programme (SAP). But because of improper implementation the

programme failed. Though the country still used the policy based planning technique in line with international practices in the developed economy. The tendency is often to assume that the effects will be minimal and non-destabilizing whereas the adverse consequences arising from it does not in any way depend on such comparative size but on the volume of income or money that will be pumped into the system when it is been finance. According to Akinmulegun (2014), budget deficits are considered as the causes of macroeconomic problems, such as high level of inflation, current account deficits, high indebted economy and slow economy growth.

1.1 Objectives of the study

The specific objectives are

(i) To determine the effect of government deficit budget on economy growth.

(ii) To determine the impact of inflation on economic growth.

(iii) To determine the relationship between government expenditure and economic growth.

2.0 Review of Related Literature

2.1 Theoretical framework

The following theories are postulated on budgeting deficit

2.1.1 Keynesian theory

This theory was propounded by John Maynard Keynes (1883-1946). This theory states that economy is being inherently unstable and as requiring active government intervention to achieve stability. The theory viewed that spending is what pulls forth the output, and thus supports employment and income. Keynesian economics emphasizes that if we can understand employment, there is production of output and income in the economy. Mainstream economists prior to the time of Keynes emphasized the importance of supply. Keynes posits that spending leads to increase in current production. Business will produce only quantity of goods and services they believe in consumers, investors, government and foreigners will plan to buy. If this planned aggregate expenditure are less than economy's full employment, output will fall short of its potential. When aggregate expenditures are deficient, there are no automatic forces capable of assuring full employment

2.1.1 Monetarist theory

Monetarist economics refers to the "School of economic ideas and theories" usually associated with Professor Milton Friedman. It places primary emphasis on the size of money supply in determining macroeconomic conditions and prices in the economy (Ojong & Hycent, 2013). Monetarist is one modern-day version of classical theory. The monetarists were arguing and building their case against the whole idea of government fiscal policy of adjusting taxes and spending to influence the economy. According to Abu and Achegubuly (2012), the basic tenets of monetarism are that:

(i) Velocity of circulation is essentially stable.

(ii) Money can exert its influence over national income through a number of channels. It could be through interest rates affecting investment, through wealth effects on consumption, etc.

(iii) Wages and prices are quite flexible. This proposition supports the claim that when an economy is not at full employment equilibrium, price adjustment will restore equilibrium. Thus the economy is always close to full employment so that any change in money supply affects prices.

(iv) The economy is inherently stable.

(v) Individuals, firms and workers have rational expectations which are self-reinforcing and stabilizing.

2.2 Conceptual framework

According to Taiwo and Agbatogun (2011), deficit financing has major implications for the macroeconomic environment. However, this will depend on the level of employment. In a situation of less than full-employment, deficit financing could contribute to growth. This will result as idle capacities are employed in the economy. However, when full employment is already achieved; excessive deficit financing could affect the economy, thereby leading to serious macroeconomic problems (Miller, 1983). However, if deficit financing is channeled into investment in productive activities such as capital goods, training or new technology, the economy might grow faster than the burden of the growth. The consequences of fiscal deficits usually depend on how they are financed. But if the deficits are excessively used, they will bring about macroeconomic imbalances. This therefore, implies that the mode of deficits financing is of greater policy relevance than the level of deficits. Generally, large and persistent fiscal deficits financed mainly by borrowing from the Central Bank usually contribute to macroeconomic instability. Overall, this will adversely affect output growth. The persistent financing of government deficits through advances from the Central Bank implies that the objectives of mobilizing domestic savings could not be fully realized. (Okolo, Momary, Lucas & Abia, 2014) This mode of financing government deficit often leads to rising inflationary pressure in the economy. This is because it increases the reserve base of commercial and merchant banks, thereby creating excess liquidity in the financial system. Furthermore, financing the deficit through the private banks will bring about a reduction of loanable funds that are available to the private sector. Specifically, it will crowd out private investment. Deficit financing through the non-bank public could lead to the achievement of macroeconomic stability and growth. This condition holds, if the size of the overall deficit is about 3 percent of the gross domestic product (GDP). On the other hand, if the level of the budget deficit becomes unsuitable, the reliance on non-bank public for the financing may lead to other macroeconomic problems (Gbosi, 2015). Apart from crowding out private savings and investment from the real sector of the economy, thereby resulting in low real growth, it would also intensify inflationary pressures. The decline in output will not be a serious problem if the deficits are channeled into public investment to complement private investment. (Vincent, Loraver & Wilson, 2012). If the government borrows from the capital market, this does not usually fuel inflationary repercussions. Similarly, external borrowing could lead to current account deficit, real exchange rate appreciation and eventually external debt crisis if the debt is unsuitable. (Steven, 2010) Available evidence shows that over the years; Nigeria's fiscal operations have resulted in persistent overall deficit. However, there were only few periods of surpluses. For example, overall deficits and surpluses fluctuated between the period 1970 and 1979 but throughout the period, 1980 and 1989, there was continuous overall deficits. Furthermore, during the period, 1980 to 1999, there were eighteen years of deficits. Specifically, the deficits ranged between N58.8 million and N164.7 million. However, as a percentage of the GDP, overall deficit increased from 8.7 percent in 1970 to 20 percent in 1975, 7.1 percent in 1982 and was 8.4 percent in 1999. These deficits were financed mainly from foreign and domestic borrowing as well as draw-down on cash balances (Ojo & Okunrounmi, 2012).

2.2.1 Deficit financing in Nigeria

Ordinarily, the deficit resulting from the fiscal operations of the federal government can be defined as the difference between the tax revenue and total expenditure (Adeboye, 2013). However, to underline the seriousness of the fiscal imbalance, fiscal deficit are identified and used in fiscal analysis. Some of the examples are:

(i) Current deficit/surplus: This defines the difference between the total current revenue and the recurrent expenditure. If it is negative, the current balance is in deficit and if it is positive the current balance is in surplus. (Abu & Achegubuly, 2012)

(ii) Primary balance**:** This is the difference between the total current revenue and total expenditure, less interest payments on public debt. This can either be a primary deficit or a primary surplus.

(iii) The overall balance**:** It is the difference between the total current revenue and the total expenditure without any exclusion. When the overall balance is negative, the fiscal operations for a given period results in an overall deficit and if it is positive, then the overall balance is otherwise known as an overall surplus.

(iv) Cyclical deficit: This is the portion of the deficit that results from an economy being at a low level of economic activity.

(v) Structural deficit**:** This is the deficit that would exist even if the economy was at its potential output. A structural deficit is not directly contributable to the behaviour of the economy and is part of the deficit for which policymaker are responsible. In other words, it is the result of decision policy makers have made about tax rates, the level of government spending and benefits levels for transfer payment (Oke, 2010).

However, to break the fiscal deficit into cyclical and structural components, we need three (3) measures of potential national output, that is, the level of national output achieved when both capital and labour are utilized at the highest sustainable rates. For economists, there is no one agreed-upon definition of output and consequently, there are several measures of the structural deficit.

2.2.2 Causes of fiscal deficit in Nigeria

(i) Political considerations

It is important to note that policies cannot be separated from economic in both developed and developing nations today; political considerations now outweigh economic considerations in most government decisions. For instance, the desire of policy makers and the political leadership to meet the expectations of the citizen as well as fulfill election promises have often driven up expenditures. Overall, this will result in deficits. These have been the Nigeria's experience in recent years.

(ii) Economic issues

In most instances, even when expenditure programs are budgeted to match expected revenue, a sharp drop in actual revenue may occur in a fiscal year. This state of affairs could bring about a deficit. This is very common in a monoculture (one commodity) economy like Nigeria. Where crude oil overwhelmingly constitutes the bulk of government revenue, where the price and demand for oil in the international oil market becomes very crucial. Apart from the above, there can also be a deficit if there is an increase in the costs of goods and services that are required by the government. Above all, deficit may also arise out of the desire to urgently finance economic infrastructure. This may also be applicable to other public investments, which are expected to promote long term economic growth and development.

(iii) Social factors

In Nigeria, as in other countries, the government plays a major role in the social sector. Deficits may also arise when there is absolute need to raise expenditure over and above projected revenue. This may be due to the occurrence of national emergencies such as floods, earthquakes, famine and other natural disasters. More importantly, other social needs, such as education, health or poverty alleviation programme can put pressure on government finances (Oke, 2010).

As earlier mentioned, there are times when expenditure outlays are higher than revenue. The government may finance the gap from various sources. It is important to know that deficit

could be financed though domestic or external sources. We analyze each of the methods of financing fiscal deficits below:

(a) Domestic sources

Under domestic sources, fiscal deficits could be financed through the banking system or the non-bank public. According to Onoh (2007), domestic sources for financing government deficits include the following;

(i) The use of accumulated cash balance;
(ii) Borrowing from individuals and firms;
(iii) Borrowing from non-deposit financial institutions such as insurance companies and the social trust fund;
(iv) Borrowing from statutory bodies, corporations, states and local governments;
(v) Borrowing from deposit-financial institutions such as the deposit money banks and other savings-type institutions;
(vi) Borrowing from money and capital markets; and
(vii) Borrowing from the central bank of Nigeria.

In Nigeria, the banking system comprises the Central Bank and the private banks. The private banks include commercial and merchant banks respectively. The financing of deficits by the banking system in this country has been dominated by the Central Bank. This is because the Central Bank becomes banker to the government. Above all, there exists the legal provision for temporary accommodation of government finances by a Central Bank. The Central Bank of Nigeria (CBN) Act 1958, (CAP as amended) empowers the CBN to grant temporary advances in the form of "ways and means" to the federal government up to 25 percent of the estimated recurrent budget revenue. However, this statutory limit was reversed in the CBN Decree 34 of 1999 to 121-122 percent of the estimated recurrent budget revenue. At this point, it is important to know that advances is an overdraft facility, which is provided by the CBN to meet the cash flow problems of the federal government. The advances are expected to be liquidated at the end of every fiscal year. Regarding the private banks, they finance the activities of government through purchase of treasury instrument. These purchases are usually through the primary and secondary markets.

Apart from the banking system, domestic borrowing can also be from the non-bank public. Specifically, the non-bank public includes insurance companies, pension and provident funds, savings and loan associations, development finance institutions, discount houses and individual investors. In addition, non-bank public borrowing can take place when government borrows from sources such as the money market and capital market respectively. This usually involves the purchase of government debts instruments. Some of these instruments could be the short term related treasure bills in the money market or development storks/bonds, which are of longer term, and tradable on the floor of the stock exchange. Generally, the ability of the government to borrow from the private sector, to a large extent depends upon two major factors. One of these factors is the level of sophistication of the financial markets. The second factor is the willingness of private investors to hold government bonds. Unlike in the case of banks, the non-bank financial institutions and the general public pay for these securities by issuing their deposit balances with banks. Discount houses deserve a special mention in this regard. Specifically, discount houses play intermediate role between the banks and the Central Bank. It is generally argued that the financing of deficits through the non-bank is preferred to that of the banking system. The argument is that the former is generally expected to be non-inflationary. However, available evidence shows that the bulk of Nigeria's fiscal deficits have been financed through the banking system. This is probably what has led to a significant increase in the domestic component of Nigeria's public debt. Therefore, adequate care should

be taken to avoid excessive borrowing from financial institutions, especially the deposit banks, which may lead to cash crunch and consequently to monetary instability (Onoh, 2007).

(b) External sources

Another major source of financing fiscal deficits is through external sources. In Nigeria, external sources of financing deficits include loans from multilateral institutions such as the World Bank and its affiliates as well as the International Monetary Fund (IMF). Funds from these sources are usually meant for development projects and the balance of payments support. Some examples of such facilities include the Official Development Assistance (ODA). Specifically, these funds are usually earmarked for development projects in the recipient countries. In addition to the above, non-concessionary credits could be provided by private banks and other private institutions. In Nigeria, only the federal government as a legal entity in international law can contract foreign loans directly. State governments are constitutionally not allowed to borrow directly from any foreign government, or foreign financial institutions without the clearance and guarantee of the Nigerian Federal Government. But during the second republic between October, 1979 and December, 1983, state government was known to have borrowed straight from the world financial markets without the knowledge of the federal government. The uncontrolled borrowing by state government contributed to Nigeria's external debt problems and the bunching of Nigeria's external debt. And because no accurate records of such debts were kept, the reconciliation and the rescheduling of the Nigeria's external debt were made difficult. The implication of external debt on the general macroeconomic policy is enormous, and as a result, the amount of external debt, the maturity pattern and the interest payments should be closely watched (Onoh, 2007).

2.2.3 Macroeconomics

Macroeconomics is the study of the operations of the economy as a whole. The focus of the analysis in macroeconomic is the total production of goods and services in the economy or Gross National Product (GNP/GDP). Thus, macroeconomics policy, generally, consists of a package or set of policy measures that are adopted by the government during a given period to achieve the stated national goals/objectives. The packages of policy elements, very often, comprise fiscal, monetary, external sector, industrial, income, environmental policies, etc. These policies are often designed to address specific problems of an economy and the objectives or goals of such macroeconomic policy are price stability, real economic growth, full employment and balance of payments equilibrium. In fiscal policy, the variables that government use in carrying out its economic policy such as tax rates and government spending are called policy variables or policy instruments.

However, there is need to appreciate that macroeconomic policy elements are interdependently in their design and implementation in order to achieve the set goals or objectives. For instance, the financing of government expenditure, through budget deficit, affect monetary policy particularly if the borrowing is made from domestic financial markets. In addition, changes in customs and excise tariff, either in the tax rates or structure, in the external sector affect government revenue and fiscal policy. Thus, the implicit impact of one policy is measured on another and must be taken into consideration in designing macroeconomic policy (Okowa, 2015). In the same vein, the attainment of macroeconomic policy goals cannot be done in isolation. For instance, in order to achieve growth, there may be need to increase government spending on investment; the financing of such investment expenditure is geared towards growth can have implication for the attainment of price stability and these relationships should be borne in mind in designing macroeconomic policy generally and fiscal policy in particular.

3.0 Research methods

The focus of the study has been on government deficit budget and economic growth. Research design is the approach or scheme which defines the tools and strategies of the research. In this study, the exploratory design is employed to identify the factors that contribute to deficit budget on economic growth in Nigeria. Secondary sources of data was employed in this study and were extracted from Central Bank Statistical Bulletin. Other relevant information sources include; relevant journals, textbooks, libraries and published materials. In analyzing the data gathered for this work, multiple regression statistical technique was employed to establish the relationship between dependent and independent variables.

The objective of the study is to establish the relationship between government deficit budget and economic growth. Based on this, the model below has been developed for the study.

GDP = f(DEFB, INF, GOVEXP)

Where;

GDP = Gross Domestic Product
INF = Inflation
GOVEXP = Government expenditure

Therefore, the functional relationship is linearized into ordinary least square (OLS) model.

$$GDP = b_0 + b_1 DEFB + b_2 \; INF + b_3 GOVEXP + Ut$$

Where;

Dependent variable = GDP
Independent variable = DEFB, INF, GOVEXP
Regression constant = b_0
Regression coefficient = $b_1 - b_3$
Stochastic error term = Ut

Analysis of data

The regression result of government budget deficit and economic growth in Nigeria (1990 to 2016).

(Regression results)

Dependent variable: GDP

Variables	Coefficient	Std. error	t-stat	Prob
C	10.00510	1.23959	8.07129	0.0000
DEFB	-0.420054	0.14090	-2.98115	0.0067
INF	-3.746673	1.65716	-2.26091	0.0336
GOVEXP	1.569728	0.25908	6.05885	0.0000

R^2 = 0.984930
R^2(adj) = 0.978402
SER = 0.737319
F-Stat = 96.28090
DW = 0.742222

The coefficient of multiple determination (R^2) is 0.9849 and an adjusted R^2 of 0.97. The later indicates that 98 percent of variations in the observed behaviour of GDP is jointly explained by the independent variables namely; DEFB, INF, GOVEXP. This shows that the model fits the data well and has a tight fit. Also, the f-statistics is used to test for the significance of such good fit. The model reports on effectively high f-statistics value of 96.28, this shows it is higher than table value. The DW statistics is used to test for the serial correlation in the residuals of the model. The decision rule is that if the calculated DW falls outside du and 4-du, then there is a serial correlation in the residuals. This shows that calculated DW of 0.7422 falls and this

indicates that the estimates should be taken with caution. The goodness of fit of the model as indicated by the adjusted R-squared shows a good fit of the model that the model fits the data well. For the overall significant of the model, the ANOVA on the f-statistics is used. Hence, the model did not occur by chance, it actually confirms that the model fits the data well. To test for the individual statistics significant of the parameters, the t-statistics of the respective variables were considered, considering their probability values. The a priori expectations about the signs of the parameter estimates are confirmation to economic theory.

4.0 Findings

The major findings of the study include; there is no significant relationship between government deficit budget and economic growth (GDP); there is no significant relationship between inflation and economic growth (GDP); and there is a significant relationship between government expenditure and economic growth (GDP).

5.0 Conclusion/Recommendations

The study examined deficit budget, inflation and government expenditure on economic growth. It is revealed that government expenditure has a significant impact on economic growth. On the other hand, inflation and deficit budget do not have a positive impact on the growth of Nigerian economy. Deficit budget is viewed as a conscious or deliberate plan by government for an excess expenditure over revenue in its budgetary allocation over a long period of time. The negative impact of the budget deficit on the economic growth is because governments are short of resources to meet their expenses in the long run. Their savings as well as revenues are not enough to meet their expenses. Inflation has a negative impact on economy and increase in inflation affects the interest rate, which affects the economic growth. The following recommendations are proffered:

(i) Government should strive to finance budget deficit by improving on the present revenue base rather than resulting to domestic borrowing. This can be achieved by improving its revenue sources and efficient pursuit of tax reforms.

(ii) The continuous concern of governments to maintain, within acceptable limits, the budget deficits is justified, in order to fight against inflation and its negative impacts.

(iii) Effective mechanism should be put in place to ensure that any government spending is judiciously utilized to contribute to economic growth.

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