THE EFFECT OF BUDGET DEFICIT ON ECONOMIC GROWTH IN NIGERIA

Efuntade, Olubunmi Omotayo

1 Federal University, Oye Ekiti, Nigeria

*corresponding author: olubunmiefuntade@yahoo.com

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ABSTRACT
The study examined budget deficit and economic growth in Nigeria. It specifically investigated the relationship between excess public expenditure, public revenue reduction, inflation rate, unemployment rate and real gross domestic product of Nigeria. This study adopted ex-post facto research design. Relevant data regarding the variables under-study were extracted from the Central Bank of Nigeria (CBN) statistical bulletin. The study period covered thirty-one (10) years spanning from 2009 to 2019, while error correction model was used to analyze the data. The findings revealed among other things that; there was presence of co-integration (long-run relationship) among the variables in the model, excess public expenditure and public revenue reduction has significant relationship with economic growth of Nigeria, while inflation rate and employment rate does not any positive relationship with economic growth of the country in the long run. The study therefore concluded that there is significant relationship between excess public expenditure and economic growth of Nigeria, depending on the variable of interest. Likewise, the study recommended among other things that government should ensure efficiency and effectiveness in the public financial management due to the insignificant influence of inflation rate on economic growth both in the long run and short run which is a pure indication of poor public financial management in the country. Also, the component governments in Nigeria should reduce it public borrowing as it has a significant inverse effect on the economic growth of the country in the long run.

Keywords: Budget deficit, Excess public expenditure, Public revenue reduction, Inflation rate

INTRODUCTION
Fiscal policy encompass taxation, public borrowing, public expenditure and other revenues mobilization aimed and which government can influence economic activities for the achievement of certain desirable macro-economic goals (Anyanwu, 1997). Fiscal policy also aims at the use of government budget to influence economic activities which could be deficit, surplus or balanced. It is deficit when government expenditure exceeds revenue. Governments often engage in huge investment activities (fiscal deficit) which is believed will not only influence gross domestic
product but also enhance sustainable growth of the country

A deficit policy plays a vital role in assisting countries achieve macroeconomic stability, poverty reduction, income redistribution and sustainable growth. For this reason, most governments use the budget as effective tool in achieving their economic objectives. This means that large and accumulating budget deficit may not necessarily be a bad policy objective if such deficits are effectively utilized to enhance economic growth. It is in line with this that an appropriate operational definition and measure of budget deficit must be clearly stated. Otherwise, the occurrence of large nominal budget deficit may be misleading depending on the operational measure adopted by a particular country. Also, deficits bring about a reduction of loan-able funds that are available to the private sector. Specifically, it will crowd out private investment in the real sector, private savings, result to low growth and intensive inflationary pressures, current account deficits, real exchange rate appreciation and external debt crisis if the debt is unsustainable.

According to Premchard (1984) budget deficit implies an increase in the supply of government bonds. In order to improve the attractiveness of these bonds the government offers them at a lower price, which leads to higher interest rates. The increase in interest rates discourages the issue of private bonds, private investment and private spending. In turn, this contributes to the financial crowding out of the private sector. Budget deficit arises when the demand for government expenditure far exceeds government revenue that needs to be financed by net lending. For the economy of Nigeria, there has been persistent tendency towards budget deficit since independence as a result of ever-expanding government expenditure, inadequate revenue generation capacity of government and increasing debt levels (Pomeyie, 2001)

Miller (2007) argued that government deficit spending is a primary cause of inflation. These studies have supported the proposition that the Central Bank will be obliged to monetize the deficit either now or in later periods. Such monetization results in an increase in the money supply and the rate of inflation.

Aschauer (1989) argued that higher investment may raise the marginal productivity of private capital and thereby crowd-in private investment. He further noted that public capital, infrastructure capital such as highways, water systems and airports are likely to bear a complimentary relationship with private capital. It is also argued that an increase in the budget deficit would induce upward pressure on interest rate causing capital inflows and an appreciation of the exchange rate that will increase the current account deficit.

Despite the fact that Nigeria has been operating deficits for these periods and also found itself in a situation of less than full employment, her economy has been in distress, the opposite view of the essence of deficits occur. There was obvious fall in the standard of living of the citizens, decline in the growth of the economy, persistent unfavorable balance of payment, increased public debt; local and foreign, continued depletion of the foreign reserve, little or no savings, decline in exports, increased
inflationary pressure, continuous dependence on external economies etc.

It is important to note that budget deficits have many implications on economic growth. Large and persistent fiscal deficits usually contribute to macro-economic instability. It will adversely affect output growth and raise inflationary pressures in the economy.

However, in a situation of less than full employment, budget deficits could contribute to growth as a result of the idle capacities that are being employed in the economy. Therefore, deficits 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. Gbosi, (2004).

All these are indicators of negative growth, its impact on these macroeconomic variables has been unfavorable, and one then asks if budget deficits no longer stimulate economic growth?

Secondly what are the policies that will enhance budget deficit in the Nigeria economy

In view of this, therefore, this study tends to undertake the effect of budget deficit on economic growth in Nigeria.

**REVIEW OF RELATED LITERATURE**

**Concept of Budget Deficit**

A deficit policy plays a vital role in assisting countries achieve macroeconomic stability, poverty reduction, income redistribution and sustainable growth. For this reason, most governments use the budget as effective tool in achieving their economic objectives. This means that large and accumulating budget deficit may not necessarily be a bad policy objective if such deficits are effectively utilized to enhance economic growth. It is in line with this that an appropriate operational definition and measure of budget deficit must be clearly stated. Otherwise, the occurrence of large nominal budget deficit may be misleading depending on the operational measure adopted by a country. Budget deficit is the economic challenge of many countries in recent decades. This problem is more widely seen in developing countries, as they are deprived of efficient private sector. This leads to extending governmental activities and increasing government economic share in such countries such that a main share of total demand is assigned to expenditure and government investment. In contrast, in revenue side, government lacks adequate revenues to cover its huge expenses. The result of such process in these countries is nothing but permanent budget deficit. If government relies on banking resources for financing the budget deficiency, it may lead to economic inflation such that internal (domestic) imbalance would also transfer to the external economic sector, since increased government expenditure initially leads to increased growing of total demand. While, government increased expenditure at total supply side may not result in increased supply due to economy’s structural problems and total supply unattractiveness. The
ultimate result of these effects is emerging of inflation in the economy. In this situation, importing increases and exporting decreases by a particular country.

**Determinants of Budget Deficit**

In general, changes in budget deficit is attributed to changes in government spending or tax revenue or both. Government receives revenue in its daily transactions and on capital items in the form of taxes and interests. On the other hand, government pays for daily activities and capital items such as administrative expenses, loans and grants. Thus, budget deficit increases when government spending persistently exceeds its revenue. If expenditure continue to mount up throughout the years whereas revenues especially taxes are poorly collected, it widens the budget deficit position of the country. In this case, the accumulated value of past deficit creates increase debts which must be financed together with the accompanying interest payments.

**Influence of Government Expenditure on Budget Deficit**

A method of determining sustainable budget deficit is to check whether government revenue and expenditure are cointegrated. This implies that there may be significant long-term economic relationship between these two variables. There are four hypotheses that examine the influence of revenue and expenditure on budget deficit. The tax-spend hypothesis postulates that raising taxes in an attempt to reduce deficit also causes expenditure to rise. It means that government raises tax revenue ahead of engaging in new expenditure. Contrary, the spend-tax hypothesis predicts that government initially incurs expenditure and then increases tax revenue to finance the deficit.

**Government Revenue**

Government revenue includes all amounts of money or income received from sources outside the government entity. This includes taxes, loan repayments, direct income, interests and grants obtained locally and externally.

**Government Expenditure**

Government expenditure involves spending by government authorities on goods and services. This includes spending on road maintenance, health, administration and security. It also includes subsidies, grants and debt servicing.

**Gross Domestic Product**

Gross domestic product is the measure of changes in physical output in an economy between different time periods by valuing all goods and services at the same constant price. Thus, it measures the value of final goods and services produced in a given year when valued at constant prices [Parkin and Bade, 2003].

**Effect of Budget Deficit on Economic Growth**

A model involving variation in inflation, government expenditure during wartime, cyclical fluctuation in output during economic boom and recession in the postwar
period was tested if it differs significantly from those during the world wars in the Swiss federal state. The estimate showed some cyclical fluctuation in the world war periods. This supports the assertion that significant determinant of budget deficit is increase in state expenditure during wartime. In this case, civilian expenditure was reduced and/or taxes increased to finance military expenditure during the war [Gebhard and Silika, 2006: 18-21]. In Nigeria, changes in inflation, interest rate and real GDP have reacted negatively to changes in budget deficit. For instance, high inflation in 1983 caused budget deficit to increase by 35.8 percent due to decline in direct tax revenue. Also, changes in real interest rate increased budget deficit by 11.3 percent of GDP in 1984. Again, high wage bill increased the deficit by 2.5 percent in 1985. Thus, changes in macroeconomic variables have had strong impact on the fiscal deficit in Ghana. However, these effects have become less pronounced over the past years as the Ghanaian economy has grown more stable (Wetzel & Roumeen, 1991).

Related Theoretical Review

Keynesian theory

The Keynesian macroeconomics theory indicates that budget deficit should be applied as a means of improving economic status and as a proper policy, should enable politicians to maximize social welfare. Thus, in Keynesian perspective, governments deal with the variables of production growth and unemployment; it also follows the policy that minimizes the difference between real unemployment and normal level of unemployment. Therefore, Keynesian theory predicts that budget deficit is negatively correlated with unemployment; whereas, budget deficit is positively related with economy’s real growth rate. Therefore, economic growth rate variable is introduced as changes in gross domestic product (GDP) growth to examine this theory. The variable coefficient demonstrates that financial policies must be employed in a way that leads into improved economic production level (Roubini and Sachs, 1997).

Ricardian Theory

David Ricardo initially introduced this theory, which was finally completed by Robert Baroo. This theory created based on the two assumptions of rational expectations that households are prospective and households’ visions until taxation. As taxes reduced and budget deficit supplied through borrowing, the government would have no choice of increasing taxes in the future in order to repay the debts and interests. According to this perspective, Ricardo believes that people found out by experience that increased government bond as a result of reduced taxes offers a temporary income (revenue) for the individual at the present time. Following increased government debt, these consumers save more to provide higher tax paying in the future; thus, increased public saving offers more credit to families and economic enterprises.
The Neoclassical Model

The neoclassical school proposes an adverse relationship between fiscal deficits and macroeconomic variables. They argue that fiscal deficits leads to higher interest rates, discourages the issue of private bonds, private investments and private spending, increases inflation level, and cause a similar increase in the current account deficits and finally slows the growth rate of the economy through resources crowding out. The Neoclassical school considers individuals planning their consumption over their entire cycle. By shifting taxes to future generations, fiscal deficits increase current consumption. By assuming full employment of resources the neoclassical school argues that increased consumption implies a decrease in savings. Interest rate must rise to bring equilibrium in the Capital markets. Higher interest rates, in turn, result in a decline in private investment, domestic production and an increase in the aggregate price level.

Optimized finance theory

According to Barro (1974) theory, households definitely predict the government increases taxes in the future due to the generated budget deficit. Therefore, the government issues bonds in the present time; increased bonds are not considered as wealth by public in order to obtain more consumption (this is known as Ricardian equivalence assumption earlier discussed). Probably tax payers save tax cut revenues at the present time meaning that as if permanent tax cut never occurred in the economy. In this regard, Barro (1974) presented a model by which individuals borrow from government according to predicting government budget deficit by state financial deficit, save the loan and pay the loan interest as tax; therefore, budget deficit in long-term is not an effective means for lessening the crisis. The question raised here by Barro is that why politicians use budget deficit for improving production variations and economic crisis?

The questioned is answered in this way that business cycles including tax fluctuations require deficit in recession and surplus in prosperity; in this way, the government keeps tax rate and expenditure constant and achieves macro balance. Thus, optimized finance theory explains budget deficit policy that budget deficit is positively related to general government expenditure deviation from normal way and negatively related to deviation of economic productions. It stated that Barro used a linear relationship between income and government expenditure for its theory.

Review of Empirical Studies

Different opinions have indeed continued to emerge on how budget deficit can affect economic activities. The genesis of these controversies has been traced to the theoretical exposition of the different schools of thought namely: the Classical; the Keynesian; and the Neoclassical schools of thought (Tchokote, 2001).

To the Classical school of thought, budget deficits incessantly financed by debt crowds-out private investment and by extension lowering the level of economic growth. As summarized by Tchokote (2001): "The classical economists believe that
debt issued by the public has no effect on the private sector savings. To them, a deficit financed by increasing the supply of securities, ceteris paribus reduces its price and raises real interest rates and this crowds out private investment. In sum, excessive deficit can lead to poor economic performance.”

In contrast, the Keynesian school of thought postulates a positive relationship between deficit financing and investment and consequently on economic growth. This school of thought sees fiscal policy as a tool of overcoming fluctuations in the economy. As put by Tchokote (2001) “This school regards deficit financing as an important tool to achieve a level of aggregate demand consistent with full employment.

When debt is used to finance government expenditures, consumers’ income will be increased. Given that resources are not fully utilized, crowding-out of private investment by high interest rates would not occur.” The position of the Keynesian school of thought on the possible effects of fiscal deficits on economic activities has been challenged by the Neo-classical school of thought on the premise that the former school ignores the significance of how fiscal deficits are financed on the effect of this policy variable on macroeconomic performance. The Neoclassical school postulates that the manner in which deficits are financed is capable of influencing the level of consumption and investment and by extension affect economic growth.

One of the labels attached to the Neoclassical argument is the Ricardian equivalence, which states that consumers foresee tax cut today paid for by deficit and borrowing, will lead to a tax increase in the future. In anticipation of the future tax increase, consumers save rather than spend the income from tax cut. If the Ricardian equivalence holds, reduction of fiscal deficit will not affect the level of consumption or balance of payments in the economy and the basis for deficit reduction, as part of stabilization programmes, no longer exists. (Tchokote, 2001).

Egwaikhide (1998) appraises the implication of Nigeria budget deficit profile for inflation and the current account balance. Evidence indicates that fiscal indiscipline in terms of lack of control over expenditure is the major determinant of budget deficit in Nigeria, while its mode of financing has aggravated inflation in the country. Most importantly, it is revealed that budget deficit correlates highly with current account deficit, implying that external disequilibrium is partly attributable to endogenous factors.

Folorunsho and Abiola (2000) examined the long-run determinants of inflation in Nigeria between 1970 and 1998, using the econometric methods of cointegration and error correction mechanism. They found that inflation in Nigeria could be caused by the level of income, money supply, and public sector balance.

Nwodo (2001) analyzed the long-run effect of budget deficit on economic growth of Nigeria for the first half of the 1990s. The main findings were that budget deficit did matter, but only to the extent it contributed to the money growth and if not checked, induces inflation, hence, leading to a distorted economy. As most of the budget
imbalance was being monetized during that period, it is no surprise that independent influence of the budget deficit on the GDP growth was not found.

According to Omoka and Oruka (2010), who employed Pair Wise Granger Causality Test in an attempt to offer evidence on the causal long term relationship between budget deficit, money growth and inflation in Nigeria, considering the broadest definition of money supply, found that money supply causes budget deficit which means that the level of money supply in the Nigerian economy will determine whether there has been or there will be budget deficits.

According to Ben (2010), larger budget deficit has adverse effect on the economy because it tends to reduce national savings, which in turn reduces domestic investment and increases borrowing from aboard. Besides, a low level of national savings raises inflation and domestic interest rates and ‘crowds out’ private sector investment. The reduction in investment in turn affects employment as firms or business reduces their demand for labour and other factor inputs. All of these reduce national output, which in turn lead to trade deficits and reduction in the overall well-being of the people.

Obi and Abu (2009), explains that fiscal deficits and government debt have positive impact on interest rates, but inflation and international trade were found to have negative effect on interest rates. In their study using vector autoregressive model and covering a period of 1985-2006 suggested that deficit financing leads to a huge debt stock and tends to crowd out private sector investment, reducing the access of investors to adequate funds, thereby raising interest (and/or lending) rates.

**METHODOLOGY**

The data for this study was obtained mainly from secondary sources. In order to examine the effect of budget deficit on economic growth in Nigeria, information from the Central Bank of Nigeria Statistical Bulletin concerning Gross Domestic Product (GDP), Excess Public Expenditure (EPE), Public Revenue Reduction (PRR), Inflation Rate (INFR), Unemployment Rate (UMR) covering the period of years 1989-2019 (10years) was used. Other Secondary Sources of data are relevant articles, journals and newspapers.

**Model Specification**

The following mathematical model was developed to analyze the effect of budget deficit on economic growth in Nigeria using Excess Public Expenditure (EPE), Public Revenue Reduction (PRR), Inflation Rate (INFR), Unemployment Rate (UMR) as the independent variables and regressed against the dependent variable Gross Domestic Product (GDP) used as proxy for Economic Growth.

This study employed the model specified below.

\[
Y_{lt} = \alpha_{lt} + \beta_1 EPE_{lt} + \beta_2 PRR_{lt} + \beta_3 INFR_{lt} + \beta_4 UMR_{lt} + \epsilon_{lt}
\]

\[3.1\]
where Y represents economic growth in Nigeria measured by Gross Domestic Product (GDP) and.

\[ Y = \alpha + \beta_1 EPE + \beta_2 PRR + \beta_3 INFR + \beta_4 UMR + \epsilon \]

\[ \alpha = \text{the constant term} \]
\[ EPE = \text{Excess Public Expenditure} \]
\[ PRR = \text{Public Revenue Reduction} \]
\[ INFR = \text{Inflation Rate} \]
\[ UMR = \text{Unemployment Rate} \]
\[ \beta = \text{the coefficient of the function} \]
\[ \epsilon = \text{error term}. \]

Since Gross Domestic Product (GDP) is the proxy to be used in measuring economic growth in Nigeria. In this study, the model will be modified as follows:

\[ GDP = f(EPE, PRR, INFR, UMR) \]

\[ GDP = \alpha + \beta_1 EPE + \beta_2 PRR + \beta_3 INFR + \beta_4 UMR + \epsilon \]

The results from the Augmented Dickey-Fuller Test for Unit Root are summarized as follows:

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>ADF TEST STATISTIC</th>
<th>5% CRITICAL VALUE</th>
<th>ORDER OF INTEGRATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>3.083192</td>
<td>-2.948404</td>
<td>Stationary at level form, 0(1)</td>
</tr>
<tr>
<td>EPE</td>
<td>-5.784503</td>
<td>-2.981038</td>
<td>Stationary at level form, 0(1)</td>
</tr>
<tr>
<td>PRR</td>
<td>-7.754226</td>
<td>-2.967767</td>
<td>Stationary at level form, 0(1)</td>
</tr>
<tr>
<td>INFR</td>
<td>-5.726747</td>
<td>-2.951125</td>
<td>Stationary at first difference, 1(1)</td>
</tr>
<tr>
<td>UMR</td>
<td>-5.747143</td>
<td>-2.981038</td>
<td>Stationary at level form, 0(1)</td>
</tr>
</tbody>
</table>


These results show that at 5% critical value, Gross Domestic Product (GDP), Excess Public Expenditure (EPE), Public Revenue Reduction (PRR) and Unemployment Rate (UMR) are stationary at level form in absolute value, (i.e. they are integrated at order zero; 0(1)) while Inflation Rate (INFR) is not stationary at level form 0(1) i.e., they are not integrated at order zero; 0(1) but The variables are only stationary at 1st difference. That is, they are integrated at order one; 1(1). This result is expected, since most macro-economic time-series data are known to exhibit non-stationary at level form.

Since all the variables are not stationary (i.e. at level form), we go further to carry out the cointegration test. The essence is to show that although all the variables are not
stationary, the variables have a long term relationship or equilibrium between them. That is, the variables are cointegrated and will not produce a spurious regression.

**Evaluation of Regression Result**

**Table 2: Results of Regression Analysis**

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>Stand Error (S.E)</th>
<th>t*-Statist value</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant (C)</td>
<td>308.9954</td>
<td>19.7709</td>
<td>15.62881</td>
<td>0.0000</td>
</tr>
<tr>
<td>GDP</td>
<td>-0.080437_{GDP}</td>
<td>0.071814_{GDP}</td>
<td>-1.120070_{GDP}</td>
<td>0.2716</td>
</tr>
<tr>
<td>EPE</td>
<td>-0.045076_{EPE}</td>
<td>0.033153_{EPE}</td>
<td>-1.359628_{EPE}</td>
<td>0.1841</td>
</tr>
<tr>
<td>PRR</td>
<td>+0.005574_{PRR}</td>
<td>0.624806_{PRR}</td>
<td>0.008922_{PRR}</td>
<td>0.9929</td>
</tr>
<tr>
<td>INFR</td>
<td>+0.07051_{INFR}</td>
<td>0.021337_{INFR}</td>
<td>3.304768_{INFR}</td>
<td>0.0025</td>
</tr>
<tr>
<td>UMR</td>
<td>+0.459569_{UMR}</td>
<td>0.227199_{UMR}</td>
<td>2.022764_{UMR}</td>
<td>0.0521</td>
</tr>
</tbody>
</table>

*Source: E-View 9.0 (2020)*

\[ f^* = 98.99854 \]

\[ R^2 = 0.942856 \]

Adjusted \( R^2 = 0.933332 \)

**Evaluation of Regression Results**

**Evaluation based on Economic Criteria**

This subsection is concerned with evaluating the regression results based on a priori (i.e. theoretical) expectations. The sign and magnitude of each variable coefficient is evaluated against theoretical expectations.

The signs of the variable coefficients from the estimated model are in line with a priori expectations. Gross Domestic Product (GDP) and Public Revenue Reduction (PRR) has a negative relationship on economic growth (GDP) while Inflation Rate (INFR), Private Investment (PI) and Private Savings (PS) shows a positive relationship each on Economic Growth (GDP).

The constant term is estimated at 308.9954, which means that the model passes through the point 308.9954 Mechanically, if all independent variables were zero, real GDP would be 308.9954 (Gujarati and Sangeetha, 2007).
The estimated coefficient for Gross Domestic Product (GDP) is -0.080437, Excess Public Expenditure (EPE) is -0.045076, Public Revenue Reduction (PRR) 0.005574, Inflation Rate (INFR) 0.07051 and Unemployment Rate (UMR) 0.459569. This implies that if we hold all other variables affecting economic growth constant, a ₦1 increase in Excess Public Expenditure will lead to a ₦0.080437 decrease in the GDP. And a ₦1 increase in Public Revenue Reduction will lead to a ₦0.045076 decrease in the GDP on the average.

On the other hand, a ₦1 increase in Inflation will lead to ₦0.005574 decrease in the GDP also a ₦1 increase in unemployment rate will lead to ₦0.07051 and a ₦1 increase unemployment rate will lead to ₦0.459569.

More broadly, Excess Public Expenditure and Public Revenue Reduction has a negative effect on economic growth in Nigeria while Inflation Rate and Unemployment Rate has negative effect on economic growth of Nigeria. Durbin – Watson statistics = 0.895419

**Evaluation of Regression Results**

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This subsection is concerned with evaluating the regression results based on apriori (i.e. theoretical) expectations. The sign and magnitude of each variable coefficient is evaluated against theoretical expectations.

The signs of the variable coefficients from the estimated model are in line with a priori expectations. Excess Public Expenditure (EPE) and Public Revenue Reduction (PRR) has a negative relationship on economic growth (GDP) while Inflation Rate (INFR), Unemployment Rate (UMR) shows a negative relationship each on Economic Growth (GDP).

The constant term is estimated at 308.9954, which means that the model passes through the point 308.9954 Mechanically, if all independent variables were zero, real GDP would be 308.9954 (Gujarati and Sangeetha, 2007).

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decrease in the GDP on the average. On the other hand, a N1 increase in Inflation Rate will lead to N0.005574 decrease in the GDP also an increase in Unemployment Rate will lead to N0.07051 and a N1 increase in Public Revenue Reduction will lead to N0.459569.

More broadly, Excess Public Expenditure and Public Revenue Reduction has a negative effect on economic growth in Nigeria while Inflation rate and unemployment Rate has negative effect on the economic growth of Nigeria. These variables are relevant to the study because changes in government spending or revenue create changes in fiscal deficits. For instance, rapid increase in government expenditure coupled with shortfalls in tax revenue will persistently create budget deficit.

CONCLUSION
The study sought to evaluate the budget deficit in Nigeria between 2009 and 2019. The estimation used operational budget deficit due to the inclusion of real interest payment in primary deficit. This is a good choice since interest payment ultimately limits the deficit finance through growth of accumulated debt. Sustainability analysis requires government to be able to service its debts without large future correction to the budget. This would avoid rolling over initial debts with the interest forever. The unit root tests favoured the stationarity of the variables at 1 percent significance level after first differencing. This means government expenditure and revenue are integrated of order one process. Also, a Granger causality test supported the existence of bi-directional causality between the variables. Hence, past and present values of government revenue provide important information to forecast future values of expenditure. The Engle-Granger cointegration test achieved a cointegration vector of 0.991195 at 1 percent level of significance indicating long run cointegration relationship between government expenditure and revenue. It shows that approximately 80 percent of variations in government expenditure of Nigeria are explained by variations in government revenue. The linear restriction test showed that is statistically not different from β one at 10 percent Significance level. This indicates sustainability of budget deficit in the strong sense. Also, the error correction model achieved the conventional negative sign at 5 percent significance level. This indicates that approximately 53 percent of disequilibrium is restored every year following shock to the system. This is relatively large indicating greater rate of convergence toward equilibrium. The diagnostic tests showed that government expenditure and revenue of Nigeria exhibits no heteroscedasticity and autocorrelation. Also, a normality test based on Jarque-Bera supported the normality assumption. It is recommended that efforts should be made to consistently increase government revenue as revenue and expenditure must be stationary and integrated of the same order. Since reduction in government expenditure is not plausible, the tax should be expanded to capture all “taxable” individuals and firms. This would
ensure that expenditure do not move too far away from revenue. Any policy to increase expenditure in Nigeria should consider past and present values of government revenue. This is because expenditure and revenue take temporal precedence over each other.

**RECOMMENDATIONS**

- Government should focus and direct its expenditure towards the production of goods that will stimulate general productivity in the economy to enhance GDP growth. Attention should focus on the real sectors.

- Fiscal discipline should be encouraged and time limits should be set for the realization of goals which would encourage commitment, probity, accountability and transparency by public fund managers.

- Mechanisms to ensure that borrowed funds are not diverted to private pockets, embezzled or misappropriated, should be put in place else government should redirect policy towards living within its own means.

- Government fiscal policies should focus on the diversification of the economy so as to enhance the performance of the non-oil sector, and to ensure growth in the economy.

- Government should also ensure a more friendly tax policy to avoid the crowding out effect it may have on private sector contribution to the growth of the economy. This crowding out of essential investment might have an adverse impact on the long-run economic growth and should be avoided.

- Monetary authorities should ensure that effective monetary policy should be geared towards balancing the supply of money toward budget deficits so as to maintain a favourable inflationary rate. Expansionary monetary policy increases the supply of loanable funds available through the banking system causing interest rate to fall thus, increasing private investment.

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