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FISCAL DEFICIT AND GROWTH IN NIGERIA ECONOMY

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ABSTRACT

This study examines the impact of fiscal deficit on economic growth in Nigeria for period of 1980 to 2018. Sequel to the mixed level of stationarity of the variables as evidence in the result of the unit root test, this study adopts auto-regressive distributed lag (ARDL) technique and the result of the study shows that fiscal deficit is detrimental to economic growth in Nigeria. This study is in tandem with neoclassical paradigm. The study argues that one of the main reason why fiscal deficit is adversely affecting the economic growth in Nigeria is because of the pattern of her public spending which is heavily skewed in favour of recurrent expenditure which may not stimulate growth. Thus, the study recommends that government should review her pattern of spending to favor productive sector by so doing the economy will strive to greatness. Also, government should minimize her borrowing and look inward for ways to generate revenue. Lastly, if government wants to operate fiscal deficit, it should be only during recession and high unemployment.

Keywords: Fiscal deficit, neoclassical paradigm, Keynesian theory, Ricardian equivalence hypothesis

INTRODUCTION

For any country to move from the category of developing countries to developed countries, there is need for aggressive spending on social and economic infrastructure. Rostow (1960), in his theory of stages of development, stated different stages that countries of the world must pass through before they could develop, namely: the traditional society, the preconditions for take-off into self-sustaining growth, the take-off, the drive to maturity, and the age of high mass consumption. One of the conditions to move from take-off stage of development to self-sustaining growth is the mobilization of resources to generate investment which will accelerate growth (Todaro and Smith, 2012). Keynes also buttressed that huge government spending do increase domestic production, stimulate demand, make

the private sector better-off and enhance economic growth (Aero & Ogundipe, 2018). According to Hussain and Haque (2017), huge government investment is required to develop the social capital and infrastructure which will pave way for the private sector to come forward and invest then reduce unemployment, increase national output and consequently enhanced economic growth. Unfortunately, most developing countries, Nigeria inclusive, have very limited resources which are insufficient to carry out the needed projects. The mono-economy nature of Nigeria economy with heavy reliance on revenue from crude oil which is highly volatile and its price been determined by external forces made the case of inadequate fund more worrisome (Adegboyo, 2020). Furthermore, the inadequate fund to provide for the essential growth-enhanced infrastructure was made worse by imprudent public spending vis-à-vis mismanagement of public fund (corruption) of the little available fund. Also With globalization, developing countries lost a historically reliable source of income from tariffs due to trade liberalization, but failed to recover the lost revenue by introducing tax reform in the form of a value added tax (Shetta & Kamaly, 2014). The country is left with few options of financing her budget and one of the easiest way is for the country to operate a deficit budget (Momodu & Monogbe, 2017) and (Ali and Ahmad, 2014). Deficit financing can be seen as the practice of seeking to stimulate a nation's economy by increasing government expenditures beyond revenue sources (CBN, 2010). For the past forty years Nigeria has been operating a deficit budget. However, despite the continuous increase in the government expenditure in Nigeria over the years, the economic has not grown as expected. There is high rate of unemployment, poor infrastructures, and high rate of poverty among others. Therefore, this study will investigate to determine the impact of fiscal deficit on Nigeria economy. Generally, the impact of fiscal deficit on economic growth is one of the contentious issues both theoretically and empirically with no conclusion. Theoretically, Keynesians are of the opinion that fiscal deficit enhance economic growth, Neo-classicalists are of the view that fiscal deficit is detrimental to economic growth while Ricardians argued that fiscal deficits had no impact on the economic growth as such this study will investigate to determine which of the categories did Nigeria belongs. Empirically, scholars like Nwanna and Nkiruka (2019), Yohane and Priviledge (2018), Hussain and Haque (2017), Momodu and Monogbe (2017) and Goitsemodimo found that fiscal deficit propel economic growth, while Sharma and Mittal (2019), Tung (2018), Mandara and Ibrahim (2018), Iqbal Nasir , Din Musleh ud and Ghani Ejaz (2017), Ravinthirakumaran and Kasavarajah (2016), Orkoh and Owusu (2016), Anantha and Gayithri (2016), noted that fiscal deficit inhibits economic growth and Rakesh and Sanjay (2015), Samirkaş (2014), Lwanga and Mawejje (2014), found no relationship so this study is necessitated to determine how fiscal deficit has been affecting the country.

LITERATURE REVIEW

There are different definition of fiscal deficit by different scholars, however, this study will adopt the definition of IMF which defines fiscal deficit mathematically as Fiscal deficit = {(revenue + grants) – (expenditure on goods and services + transfers) – (lending – repayments)}. It can be simply put as the excess of government expenditure over income in a given period usually a year. Fiscal deficit can be financed through domestic borrowing and external borrowing. It is expected that when fiscal deficit is properly harness, there will be infrastructural and human capital development reduction in unemployment and recovery from depression/recession which in turn increase average standing of living of the populace and consequently promotes economic growth. However, when it is not more than 3 percent of the GDP which is the international bench mark then it can adversely affects interest rate, inflation rate, deficit balance of payment, and deter economic growth (Anyanwu, 1997). It can reduce national savings which would have been use for private investment that is it crowds out private domestic investment. This will lead to reduction in capital stock and national output. As such government should only borrow when there is recession or high unemployment, or when there is a rise in a private sector savings. It can also be detrimental to development when a larger percentage of deficit budget is used to finance current consumption

Theoretical Review

- Keynesian theory: this theory was postulated by John M. Keynes. He propounded the theory during the great depression of 1929 to 1932 where he opined that increase in government expenditure will stimulate aggregate demand and consequently leads to economic growth. He advocated for government spending above her income which is fiscal deficit. Keynes argued that fiscal deficit will stimulate domestic production, increase demand for productive output, increase savings, and reduce unemployment. And that these make private investors more confident about the future of their investment in particular and the economy as a whole thereby resulting in crowding in investment. Keynes also noted that when autonomous government expenditure increases it will increase both consumption and investment which will in turn increase output in multiple of the government expenditure through a multiplier process. He however noted that fiscal deficit could adversely affects the external sector, reflected through trade deficit when the domestic economy is unable to absorb the additional liquidity through an expansion in output.

- Ricardian equivalence hypothesis: The theory was propounded by David Ricardo and later worked on by Barro (1989). The paradigm stated that budget deficit had no effect on private consumption, interest rate, as a result has no effect on economic

growth i.e. fiscal deficit neither stimulate nor hinders economic growth. The theory noted that fiscal deficit often leads to reduction in government saving, which will trigger an increase in desire private savings, therefore the desire national saving and investment remains unchanged. This is because the deficit finance means excess of government spending over tax revenue and the deficit would be financed by borrowing and the borrowed fund be paid back by a future rise in tax burden. Barro (1989) argued that budget deficits and taxation have equivalent effects on the economy. The theory assumed individuals maintain permanent consumption pattern over their life span and since the fund borrowed would be paid by future tax rise, the expansionary fiscal policy would not affect individual's present consumptions as they would be saving ahead of the unavoidable future tax rise

- Neo-classical: The model argued that fiscal deficit is detrimental to economic growth. The model buttress the argument on the fact that since fiscal deficit would be financed by increased government borrowings, it will lead to increase in interest rate which will crowd out private investment and overall deter economic growth. The paradigm noted fiscal deficit implies that governments is spending more than what it is receiving and this will lead to reduction in government saving or increase in dis-savings. This would have an adverse effect on the economic growth if the reduction in government saving is not fully offset by a rise in private saving, thereby resulting in a fall in the overall saving rate Ravinthirakumaran and Kasavarajah (2016). The theory assumed that every individual is focus and plans their lifecycle consumption and there is full employment. This paradigm has three features namely: first, the consumption of any individual is ascertained as an elucidation to an inter-temporal optimization problem, where borrowing and lending both are permitted as market rate of interest. Second, every individuals have finite lifespan. Third, clearing market at all time. Fiscal deficit stimulate aggregate demand thereby creating a high level of competition in demand for loan between private investors and government which will lead to high interest rate thereby discouraging private investments, private savings, and current account deficits, increase inflation rate and lastly slows the performance rate of the economy through resources crowding out investment (Momodu and Monogbe, 2017).

Empirical Review

Using panel set data to analysis the impact of budget deficit on the economic growth of the BRICS nations over the period of 1997 – 2016, Goitsemodimo, Yohane and Priviledge (2018), employed Modified Ordinary Least Squares (FMOLS) and the Dynamic Ordinary Least Squares (DOLS) estimation technique. The two-result showed that budget deficit instigates economic growth in BRICS nations. Also, the study showed that there is bi-directional causal relationship between budget deficit and economic growth. Similarly, Momodu and Monogbe

(2017), investigated the impact of fiscal deficit on economic growth in Nigeria over the period of 1981 and 2015. The study employed VAR and granger causality estimation technique to analysis the data. The VAR result revealed that budget deficit positively influences economic growth and granger causality result showed that there is bi-directional relationship between budget deficit and economic growth in Nigeria. On the contrary, Iqbal et al, (2017), examined the relationship between fiscal deficit and economic growth in Pakistan from 1972 to 2014 to determine the threshold fiscal deficit that will serve as benchmark for policy makers. The study adopted smooth transition autoregressive model (STAR) to analysis the data. The study revealed that 5.57 percent of GDP is the threshold of fiscal deficit in Pakistan and that most of the country's fiscal deficit is above the threshold. The study further showed that fiscal deficit had an adverse impact on economic growth. Likewise, in the study of Tung (2018) who investigated the impact of fiscal deficit on economic growth of Vietnam between 2003 and 2016 using Johansen cointegration and correlation matrix estimation technique. The two-estimation technique showed that fiscal deficit is detrimental to economic growth.

Using Vector Autoregression (VAR) framework to analysis the impact of fiscal deficit in selected South Asian countries, namely, Bangladesh, India, Nepal, Pakistan and Sri Lanka between the period of 1980 and 2014, Ravinthirakumaran and Kasavarajah (2016) found that fiscal deficit adversely affects economic growth in the selected countries except Nepal. Conversely, Hussain and Haque (2017) investigated the relationship between fiscal deficit and economic growth in Bangladesh between the period of 1993 and 2016 using VECM estimation technique. The study sourced data from two different sources i.e. World Bank data and Bangladesh Bureau of Statistics (BBS). The findings of the result of data obtained from BBS revealed that there is a positive and significant relationship between fiscal deficit and economic growth which conform to the Keynesian theory, while the findings of the result of data obtained from World Bank showed that fiscal deficit had a negative and significant effect on economic growth. Also, in addition, Maji and Achegbulu (2012) examined how fiscal deficit has been affecting economic growth in Nigeria between 1970 and 2009 using ordinary least square. The study showed that fiscal deficit stimulates economic growth in Nigeria and therefore recommends that government should increase her spending on productive sector.

Ali, Mandara and Ibrahim (2018) explored the impact of fiscal deficit on Nigeria's economic growth between the period of 1981 and 2016. The study made use of ARDL estimation technique to analysis the data. The result revealed that fiscal deficit inhibits economic growth in Nigeria. Also, Sharma and Mittal (2019) explored the impact of fiscal deficit on economic growth in India over the period of 1985 and 2015. The study employed ARDL model and Granger Causality test. The result of ARDL revealed that fiscal deficit had negatively affects economic growth while Granger causality test showed that fiscal deficit

affects economic growth through a mechanism channel i.e. a change in the value of fiscal deficit will cause inflation rate to change which in turn leads to changes in exchange rate as well as interest rate concurrently and they consequently influence economic growth. However, Samirkaş (2014) examined the relationship between fiscal deficit and economic growth in Turkey between the period 1980 and 2013. The study employed Johansen cointegration test and Granger causality test. The result showed that there is no relationship between fiscal deficit and economic growth in Turkey. In the same vein, Lwanga and Mawejje (2014) used Vector Error Correction Model (VECM) and granger causality to examine the relationship between budget deficit and some selected macroeconomic variables in Uganda between 1999 and 2011. The VECM result revealed that there is no causal relationship between economic growth and budget deficit while granger causality test showed that economic growth granger causes fiscal deficit

Using Johanson Co-integration test to investigates the impact of fiscal deficit in Nigeria between 1981 and 2016, Nwanna and Nkiruka (2019) found that fiscal deficit financed by both external and domestic loans had positive impact on economic growth. Similarly, Shihab (2014) studied the causal relationship between fiscal policy and economic growth using granger causality test between the period of 2000 and 2012. The study revealed that economic growth granger caused budget deficit and consequently recommended that government should focus on policies which facilitate increasing private investment. Contrariwise, Nkrumah, Orkoh and Owusu (2016) explored the impact of budget deficit on Ghana's economic growth. The study made use of quarterly data spanning between 2000 and 2015. Autoregressive Distributed Lag (ARDL) approach was used to analysis the data. The result revealed that budget deficit is detrimental to economic growth in Ghana. Likewise, Anantha and Gayithri (2016) investigated the effect of fiscal deficit on economic growth in India between 1980 and 2013. They used Vector Error Correction method to analyse the data. The result revealed that fiscal deficit adversely affects economic growth. He however noted that if fiscal deficit money is spent on capital formation, it will stimulate economic growth.

Biplob (2019) investigated the effect of budget deficit on economic growth in Bangladesh over the period of 1981 and 2017 using autoregressive distributed lag (ARDL) model. The study revealed that budget deficit promotes economic growth in Bangladesh. In the other hand In the study of Pakistan economy, Goher, Ather and Wali (2011) researched into the impact of fiscal deficit on the economic growth between 1980 and 2009 using two-stage least squares method (2-SLS) technique. The study revealed that fiscal deficit deters economic growth in Pakistan. While Rakesh and Sanjay (2015), in his study of India economy between 1991 and 2014 using OLS estimation technique, found that fiscal deficit had no impact on economic growth

METHODOLOGY

In line with the theories and empirical reviewed, this study specifies the model below:

RGDP =f(FDT, INTR, INFR, DPIV, EXCR)t (1)

Linearing equation (1):

RGDP =β0 + β1FDT + β2INTR + β3INFR + β4DPIV + β5EXCR +μt (2)

Where:

RGD means real economic growth (proxy for economic growth)

FDT means Fiscal Deficit

INTR means interest rate

INFR means inflation rate

DPIV means domestic private investment

EXCR means exchange rate

μ means error term

From the above variables it is evidenced that some of the data are in rate while others are not, so for all the variables to be in the same appropriate coefficient, variables that are not in rates will be logged. Although FDT is not in rate but it will not be logged because variables with negative value cannot be log. Therefore the log-linear econometrics form of the equation is presented below:

InRGDP =β0 + β1FDT + β2INTR + β3INFR + Inβ4DPIV + β5EXCR +μt (3)

DATA ANALYSIS

Variables Descriptive Properties

The descriptive characteristics of the variables are presented in Table 1. The average values of the DPI, EXR, FDT, INFR, INTR and RGDP are 5.788, 91.874, -4.667, 19.038, 17.754 and 10.276 respectively, while their median are 5.647, 97.02, -56.27, 12.778, 17.569 and 10.046 respectively. Fiscal deficit (FDT) has both the highest and lowest values with 4238.84 and -2208.22 respectively. The standard deviation shows that fiscal deficit (FDT) is the most volatile variable with 1240.995, follow by exchange rate EXR with 92.982 then inflation rate (INFR) with 16.873 while real gross domestic product (RGDP) is the most stable variable with 0.573. All the variables are positively skewed towards normality. The kurtosis that measures the peakness of the distribution reveals that fiscal deficit, inflation rate and interest rate are leptokurtic indicating that the distributions are peaked relative to normal distribution, while domestic private investment, exchange rate and real gross domestic product are platykurtic, which implies that the distribution of the variables are flat relative to normal distribution. Lastly, the Jarque-Bera statistics reveals that the variables except fiscal deficit and inflation rate were normally distributed at 5% significant level.

Table 1: Descriptive Properties of the variables

	LOG(DPI)	EXR	FDT	INFR	INTR	LOG(RGDP)
Mean	5.788666	91.87472	-4.66675	19.03763	17.7536	10.27577
Median	5.647475	97.01772	-56.27	12.7775	17.56916	10.04588
Maximum	9.739162	309.765	4238.84	72.84	31.65	11.15984
Minimum	2.174752	0.55	-2208.22	5.38	8.431667	9.53092
Std. Dev.	2.41728	92.9816	1240.995	16.87344	4.839242	0.573473
Skewness	0.067465	0.845401	2.207069	1.814096	0.102629	0.334725
Kurtosis	1.775314	2.906741	8.499664	5.138285	3.755	1.58781
Jarque-Bera	2.530101	4.779179	82.88487	29.56007	1.020259	4.07074
Probability	0.282225	0.091667	0	0	0.600418	0.130632
Observations	40	40	40	40	40	40

Source: Authors' computation

Unit root Test

The need to conduct unit root test was necessitated because most of the macroeconomic variables are non-stationary and regression on such variable will give a spurious or nonsense result. To avoid this, unit root test will be conducted on each variable and the variables are required to be stationary at level or at first difference. This study employed Augmented Dickey Fuller (ADF) to determine the stationarity of each variable. The result as presented below reveals that all the series were integrated of order one I(1) except inflation rate which was stationary at first difference I(0). Based on the result, this study will employ Auto-regressive Distributed Lag Bound co-integration technique because it is the technique that can accommodates result with mixed order of integration.

Table 2: Result of the Augmented Dickey Fuller (ADF) Unit root test

variables	Level	First difference	status
log(DPI)	0.199	-5.291	I(1)
EXR	1.547	-4.316	I(1)
FDT	-1.163	-4.641	I(1)
INFR	-3.006	-6.156	I(0)
INTR	-2.544	-5.379	I(1)
LOG(RGDP)	-0.127	-3.306	I(1)

Source: Authors' computation

Co-integration Estimate

The result of bound co-integration test is presented below. The result reveals that the value of F-statistics which is 6.077 is greater than the upper bound critical value at both 5% and 1%, indicating that there is co-integration among the variables in the model.

Table 3: ARDL Bound Co-integration Test

		Critical Value	Lower Bound	Upper Bound
F-statistic	6.07703	10%	2.08	3
k	5	5%	2.39	3.38
		2.50%	2.7	3.73
		1%	3.06	4.15

Source: Authors' computation

Regression Estimates on fiscal deficit and economic growth in Nigeria

Consequent upon the result of ARDL Bound test which reveals that there is cointegration among the variables in the model, the appropriate estimation technique for this study is Auto-Regressive Distributed Lag Error Correction Model. Therefore, the result is presented below:

Table 4: ARDLECM Regression

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(FDT)	-1.23E-05	4.97E-06	-2.47152	0.0269
D(EXR)	-0.00078	0.00026	-2.98651	0.0098
D(INTR)	0.000497	0.001516	0.328068	0.7477
D(INFR)	7.07E-06	0.000272	0.025971	0.9796
DLOG(DPI)	0.029801	0.011176	2.666559	0.0184
CointEq(-1)*	-0.2698	0.034609	-7.79553	0
R-squared	0.835972		Durbin-Watson	1.98

Source: Authors' computation

The ARDL regression estimate presented in Table 5 shows that fiscal deficit significant and negative impact on economic growth of Nigeria over the years under review, that is, the more the country operates fiscal deficit the more Nigeria's economy deteriorate. This can be attributed to the fact that government budgetary allocation is skewed heavily in favour of recurrent spending such as payment of salaries and wages, national assembly administration, debt servicing, pension and gratuities, maintenance, etc. which does not necessarily drive

economic growth rather leads to prolong fiscal deficit which obviously has serious repercussion on the national output and economic growth. This study is consistent with the neoclassical paradigm and the works of Sharma and Mittal (2019), Tung (2018), Mandara and Ibrahim (2018), Ravinthirakumaran and Kasavarajah (2016), Iqbal et al, (2017), Orkoh and Owusu (2016), Anantha and Gayithri (2016), but in contract to Keynesian theory and studies of Nwanna and Nkiruka (2019), Yohane and Priviledge (2018), Hussain and Haque (2017), Momodu and Monogbe (2017).

Similarly, exchange rate was found to have a negative and significant impact on the economic growth, that is, as exchange rate increases (i.e. Naira value depreciates), the economic growth depreciate. This conform to the apriori expectation.

Inflation rate and interest rate were found to have a positive impact on the economic growth but not significant at 5% significant level.

The result also shows that domestic private investment had a positive and significant impact on economic growth. This implies that as more private citizens invest in the country, the economy grows. This conform to the apriori expectation.

The coefficient of multiple determinant (R-square) shows that 83.6% of variation in economic growth is explained by the explanatory variables in the model while the remaining 16.4% variation is explained by other variables not captured by the model. This denotes that the variables used in the model are appropriate and suitable for the analysis. In addition, coefficient of Durbin-Watson Statistics which is 1.98 revealed that there is no serial correlation in the model.

The error correction mechanism results, which is used to measure the level of adjustment within the model reveals that the model converge to equilibrium at spend rate of 26.98%. This also implies that 26.98% of the previous year's equilibrium is in economic growth (RGDP) is been corrected by fiscal deficit, interest rate, inflation rate and domestic private investment. The implication is that the present value of economic growth will adjust to changes in fiscal deficit, interest rate, inflation rate and domestic private investment.

Diagnostic test

Diagnostic tests was conducted to establish the validity and robustness of the regression estimate. The result of normality on figure 1 reveals that that the probability value of the Jarque-Bera statistics is greater than 5%, suggesting that the residuals from the estimates were normally distributed. Also, the probability value of Breusch-Godfrey Serial

heteroskedaticity (ARCH test) in table 5 below is greater than 5% indicating that the residuals are Homoskedasticity. Similarly, the probability value of Breusch-Godfrey Serial correlation test in table 5 below is greater than 5% indicating that there is no serial correlation in the estimate. Lastly, Ramsey RESET Test indicated that is appropriate and free from error.

Figure 1: Normality Test

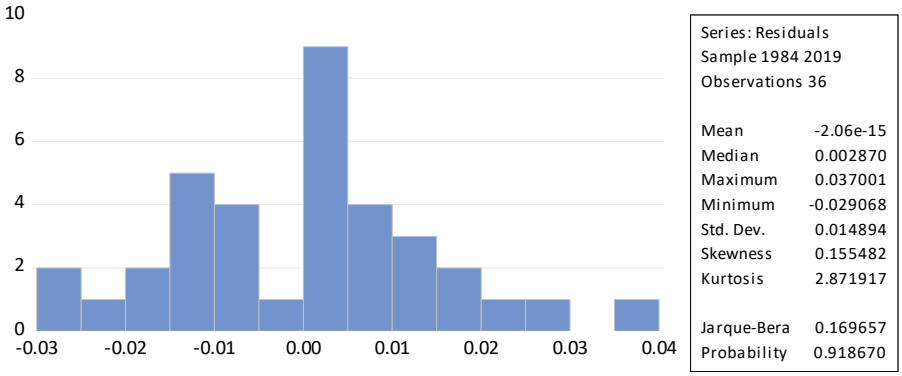

Table 5: Diagnostic tests

Heteroskedasticity Test: Breusch-Godfrey Serial	**F-Statistics 0.49976**	**Prob. 0.9268**	
Breusch-Godfrey Serial correlation test	F-Statistics 7.705594	Prob. 0.107	F(2,15)
Ramsey RESET Test	F-Statistics 0.32882	Prob. 0.5781	F(1,16)

Source: Authors' Computation (2020)

CONCLUSION AND POLICY RECOMMENDATION

This study examined the impact of fiscal deficit on economic growth in Nigeria between over the period of 1980 and 2018. Sequel to the mixed level of stationarity of the variables as evidence in the result of the unit root test, this study adopts auto-regressive distributed lag (ARDL) technique and the result of the study shows that fiscal deficit is detrimental to economic growth in Nigeria. This study is in tandem with neoclassical paradigm, and the works of Sharma and Mittal (2019), Mandara and Ibrahim (2018) and Tung (2018). The result of this study is in contrary to the Keynesian theory and the works of Nwanna and Nkiruka (2019), Yohane and Priviledge (2018), Hussain and Haque (2017).

The study argues that one of the main reason why fiscal deficit is adversely affecting the economic growth in Nigeria is because of the pattern of her public spending which is heavily skewed in favour of recurrent spending which may not stimulate growth. Thus, the study recommends that government should review her pattern of spending to favor productive sector by so doing the economy will strive to greatness. Also, government should minimize

her borrowing and look inward for ways to generate revenue. Lastly, if government wants to operate fiscal deficit, it should be only during recession and high unemployment.

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