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EFFECT OF BUDGET DEFICIT FINANCING ON THE DEVELOPMENT OF THE NIGERIAN ECONOMY: 1980-2008

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Abstract

The main objective of this study was to investigate the influence of government budget deficit financing on economic development in Nigeria. Six research hypotheses were formulated to evaluate the relationship between government budget deficit financing, unemployment, inflation, BOP, government financing, and government revenue as the independent variables and GDP as the dependent variable. Secondary data was collected from CBN statistical bulletin. Ordinary least square regression technique was used to estimate equations formulated for the study. Results of the findings revealed that: there exists a significant relationship between budget deficit financing and economic growth in Nigeria. An inverse relationship existed between GDP and unemployment in Nigeria, a direct relationship was observed between GDP and inflation in Nigeria. The findings also show that there existed a significant relationship between GDP and government expenditure and an inverse relationship was observed between government revenue and GDP. It was recommended that government should be accountable to the electorates by forestalling transparency in the preparation & implementation of budgets. Thus, a system of sound internal control mechanism should be put in place to facilitate early detection of fraud in the budgetary process. Those indicted in the process should equally be brought to book promptly by the law enforcement agencies like the Economic & Financial Crime Commission (EFCC), Independent Corrupt Practices Commission (ICPC), the police, etc. The significant figure showing deficit shows that most times, fiscal authorities' under-estimate the cost of items in the budget. Excessive deficit spending is occasioned by inappropriate planning and evaluation caused by the inexperience of economic planners. Also, government attitude of lack of transparency could be a major cause. Hence, the government should exhibit a high degree of transparency in governance so as to bring to the barest minimum deficit financing.

Keywords: Balance of payment, Government budget deficit financing, Government expenditure, Government tax revenue, Gross domestic product, Inflation, Unemployment

1.0 Introduction

Economic policies generally and fiscal policy in particular are formulated in the context of the annual budgets. The objectives of the annual budgets are the same with the macroeconomic objectives being pursued by a country at a given time. The one major problem with fiscal management from the 1970s in Nigeria was the continued reliance on the oil sector for foreign exchange earnings and Government revenue. The implication of this dependence is that the tax efforts in the country remained very low and denied the economy the benefit of automatic stabilizers, which a buoyant tax system would have impacted on the economy. In addition, it also weakened fiscal management, contributing partly to poor economic performance.

There is increasing recognition that reliance on credit from the banking system by the Federal Government in financing its budget deficits has been one of the major causes of macroeconomic instability and low growth as well as declining per capital income. The consequences of fiscal deficits usually depend on how they are financed. This therefore implies that, the mode of deficit financing is of greater policy relevance than

the level of deficit. Generally, large and persistent fiscal deficits financed mainly by borrowing from the Central Bank as in the case of Nigeria usually contributes to macroeconomic instability. Overall, this will adversely affect output growth. The persistent financing of Government budget deficits through advances from the Central Bank implies that the objectives of mobilizing domestic savings could not be fully realized. This mode of financing Government budget deficit often leads to rising inflationary pressures 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.

The experience of unsustainable deficits in most developing countries like Nigeria, leaving heavy debt burden and poor economic performance as well as substantial deterioration in social welfare suggests that financing of budget deficit in Nigeria need to be re-examined. Evidences from deficit financing in Nigeria shows that fiscal operations have been characterized by poor policy implementation, inconsistency of Government macroeconomic policy, low growth of private investments, decline in real sector growth, and fiscal indiscipline in the public sector. Furthermore, a system which enables ministries to forget about implementing the budget and its provision for over three-quarters of the year was highly detrimental to the development of the country. Budgets in developing countries like Nigeria are most often than not prepared without reference to targets and goals and little attempts made to link the budget with implementation and subsequent performance review. Thus, the budgetary process in Nigeria since independence has always emphasized expenditure rather than performance, input rather than output and little link between the objectives and targets of the government on the one hand and the budget proposals on the other. These wrong emphases result in incremental increases over the budget of the previous year. This implies a growth in budgets related to inflation but unrelated to any real need for development and not related to an ordering of government priorities.

These developments, particularly with respect to financing of budget deficits and persistent macroeconomic instability in Nigeria calls for an in-depth re-examination of the fiscal operations of the Federal Government of Nigeria as fiscal operations over the years have failed to address the fundamental macro-economic problems in Nigeria.

1.1 Objectives of the study

The main objective of the study is to examine the relationship between deficit financing and economic development.

The specific objectives include:

i. To examine the relationship between government budget deficit financing and economic development.
ii. To examine the relationship between inflation and economic development.
iii. To examine the relationship between balance of payment and economic development.
iv. To examine the relationship between unemployment and economic development.
v. To examine the relationship between government expenditure and economic development.
vi. To examine the relationship between government tax revenue and economic development.

2.0 Literature review and theoretical framework

2.1 Theoretical framework

2.1.1 Keynesian theory

Keynesianism is a label attached to the theories and policies of those economists who claim to have inherited the mantle of the great English economist John Maynard Keynes (1883-1946). After Keyne's death in 1946, Keynesianism became associated with an increased level of government intervention in the economy, especially through budget deficits and fiscal policy to fine tune or manages aggregate demand in an attempt to achieve the best policy performance (Powel, 1989). In other words, Keynesians are macroeconomists whose view about functioning of the economy represents an extension of the theories of John Maynard Keynes. Keynesians regard the economy as being inherently unstable and as requiring active government intervention to achieve stability. They assign a low degree of importance to monetary policy and high degree of importance to fiscal policy (Parkim, 1990:307).

Keynesian economics focuses on the rate of spending in an economy. Spending is what pulls forth the output, and thus supports employment and incomes. Keynesian economics emphasizes that if we can understand what determines the level of spending (aggregate demand); we will know what determines the level of employment, production of output and income in the economy (Bowden, 1982:259).

Mainstream economists prior to the time of Keynes (often called classical economists) emphasized the importance of supply. In contrast, they paid little heed to aggregate demand. The disinterest of classical economists with demand issues stemmed from their adherence to Say's Law. Named after the nineteenth century French economist, Jean Baptiste Say. Say's Law maintains that a general over production of goods relative to total demand is impossible since supply (production) creates its own demand. Say's Law is based on the view that people do not work just for the sake of working. Rather, they work to obtain the income required to purchase desired goods and services. The purchasing power necessary to buy (demand) desired products is generated by production. A farmer's supply of wheat generates income to meet the farmer's demand for shoes, clothes, automobiles and other desired goods. Similarly, the supply of shoes generates the purchasing power with which shoemakers (and their employees) demand the farmer's wheat and other desired goods (Gwartney & Stroup, 1982).

Classicists understood that it was possible to produce too much of some goods and not enough of others. At such times, they reasoned, the prices of goods in excess supply will fall, and the price of products in excess demand would rise. They did not believe though, that a general overproduction of goods was possible in aggregate, they thought demand would always be sufficient to purchase the goods produced.

Keynes rejected the classical view and offered a completely, new concept of output determination. He believes that spending induces business firms to supply goods and services. From this, he argued that if total spending fall (as it might, for example, if consumers and investors become pessimistic about the future or tried to save more of their current income), business firms would respond by cutting back production. Less spending would thus lead to less output. The message of Keynes would be summarized as follows:

> *Spending (demand) leads to increase in current production. Business will produce only quantity of goods and services they believe consumers, investors, government and foreigners will plan to buy. If these 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. Less than capacity output will result. Prolonged unemployment will persist. This was a compelling argument for the Great Depression of 1929 to 1933 (Keynes, 1936).*

Far more important, Keynesian economics dominated the thinking of macro economics for three decades following World War II. The major insights of Keynesian economics as summarized by Gwartney and Stroup (1982) include:

First, changes in output, as well as changes in prices, play a role in macroeconomic adjustment process particularly in the short-run. The classical model emphasized the role of prices in directing an economy to equilibrium level. Keynesian analysis highlights importance of changes in output. Modern analysis incorporates both. Market prices do not adjust instantaneously to economic change to decision-making and provide the impetus for price adjustments. Hence, modern economists believe that both price and output conditions play a role in adjustment process.

Second, the responsiveness of aggregate supply to changes in demand will be directly related to the availability of unemployed resources. Keynesian analysis emphasized that when idle resources are present, output will be highly responsive to changes in aggregate demand. Conversely, when an economy is operating at or near its full capacity, output will be much less sensitive to changes in demand.

Third, fluctuations in aggregate demand are important potential sources of business instability. Abrupt changes in demand are potential source of both recession and inflation. Policies that effectively stabilize aggregate demand, that minimize abrupt changes in demand, will substantially reduce economic instability.

In Keynesian era, discretionary fiscal policy was used as the principal management policy instrument, partly because the Keynesians believed it was more powerful and effective for this purpose than monetary policy

and partly because monetary policy was in the main, assigned to another objective-national debt management. But the role of monetary policy in the Keynesian era was never very dear (Powel, 1989:359).

In particular Keynesians recommend that:

a) When output is below its full employment level either
   - (i) Raise government expenditures; or
   - (ii) Cut taxes: or
   - (iii) Raise government expenditures and cut taxes together.

b) When output is above its full employment level, either
   - (i) Cut government expenditures: or
   - (ii) Raise taxes
   - (iii) Cut government expenditures and raise taxes together.

Keynesians also tend to favour a political constitution which gives centralized fiscal control so as to facilitate active fiscal policy changes (Parkin, 1982:487-488).

Apart from being an effective management instrument, recent studies revealed that fiscal instruments provide a ready source of government revenue, especially in times of crisis than the monetary policy, Chamley (1991), Chamley and Hussian (1989), Chamley and Honohan (1990). The fiscal instrument can be divided into two groups which include explicit and implicit taxes. Explicit taxes are taxes on loans, interest income and in some rare cases value added taxes. They are defined by stable statutory rates, which are subject to revision. Implicit taxes are defined as taxes, which do not appear in standard national accounts as tax revenue. Their effective rates are difficult to compute, highly variable and often unpredictable. They include taxation through seignior age, reserve requirements, lending targets and interest ceiling combined with inflation.

In the Keynesian view concerning the stability of market forces, Powel stressed that unregulated market may function in an unstable and erratic way.

In particular Keynesians stress:

a) The imperfect nature of generally uncompetitive markets, .characterized by the growth of producer sovereignty and monopoly power.

b) The importance of uncertainty about the future and lack of correct market information as potentially destabilizing forces.

c) The likelihood of breakdown of the money linkage between markets. In monetary economics as distinct from economics based on barter, money is used as a means of payment or medium of exchange for market transactions. The linkage between markets may fail if markets receiving money income from the sale of their labour in the labour market decide to hold their income as idle money balances, instead of immediately purchasing goods and services in the goods market. According to Keynesians, this causes the breakdown of Say's law that supply creates its own demand. The resulting excess savings becomes the cause of deficient demand and the involuntary unemployment of labour and other resources.

Furthermore, apostles of Keynes have disagreed with classical notion that the relationship between money and prices is direct and proportional. They share the view that it is indirect through the rate of interest (Ekpo and Osakwe, 1991:94). The Keynesian position is that money is not a "veil" rather it affects real variable in the economy.

As for the role of money in the economy, the transmission mechanism is that when there is an increase in money supply, the first impact of this change is to reduce the rate of interest. A lower interest rate has the tendency to increase investment since the later is a decreasing function of interest. An increase in investment raises aggregate demand and brings about a rise in income, output and employment. Implicit in the above view is the idea that an increase in money supply affect prices only when the level of employment has been reached and not before. Therefore, the Keynesian monetary transmission mechanism is indirect. By monetary transmission mechanism, we refer to the chain of events emanating from a change in money supply and other real variables.

2.1.2 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 (Onoh, 2007).

Monetarist is one modern-day version of classical theory. Throughout the period of the 1940s, 50s and 60s, while Keynesian economics was being integrated into the mainstream of economic understanding, a few monetarists were speaking loud and clear against Keynesian economics. In other words, monetarists are macroeconomists who assign a high degree of importance to variations in the quantity of money as the main determinant of aggregate demand and regard the economy as inherently stable. Thus, an extreme monetarist is an economist who believes that a change in government purchase of goods and services or in taxes has no effect on aggregate demand and that a change in the money supply has a large and predictable effect on aggregate demand.

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. The leading challengers have been (and are) Milton Friedman, and his colleagues who make up the "Monetarists" School (the "Chicago School") of economic thought.

According to Ackley (1980), Ekpo and Osakwe (1991), the basic tenets of monetarism, a modern variant of classical macroeconomics 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.
vi) Political action in the economic field is inevitably destabilizing and counter productive.

On economic stability, monetarists favour a stabilization policy that gives priority to the money stock as a policy variable. They attribute depressions, to the erratic behaviour of money stock. According to them, if the money stock is well manipulated and controlled, economic crises would be minimized if not eliminated.

Monetarists believe that the relationship between current consumption and income is unstable. In other words, the marginal propensity to consume varies a great deal from year-to-year so much that we cannot predict the effect of a change in government expenditure because we cannot predict the value of the multiplier during any given period.

However, since monetarists, like the classical economist believe that if left to itself, an economy will always eventually work its way back to full employment through flexible wages and prices. They see government policies such as minimum wage rates and licensing requirements as only hindering this process (Miller & Pulsinelli, 1989).

In addition, some monetarists believe that government fiscal and monetary policies often tend to destabilize the economy by increasing inflation or unemployment. These problems occur partly because between the point at which the policies are implemented and the point at which their impacts are felt on the economy make the proper timing of such policies difficult. Besides, questioning the need for and the success of government intervention, monetarists believe that the policies of getting reelected tends to bias government officials towards using fiscal and monetary policies that will result in inflation.

The monetarist point of view is summarized as follows:

> *The major impact of monetary actions is believed by monetarists to be on long-run movements in nominal economic variables such as nominal GNP, the general price level and market interest rates. Long-run movements in real economic variables such as output and unemployment are considered to have little influence, if at all, by monetary actions. Trend movements in real variables are essentially*

determined by growth in such factors as the labour force, natural resources, capital stock and technology.

In the short-run however, actions of the central bank which change the trend rate of monetary expansion or produce pronounced variations around a given trend rate exert an impact on both real and nominal variable. For instance, acceleration in the rate of monetary expansion at a time of high level of resource utilization will have little short-run influence on output but a quick influence on the price level. On the other hand, a reduction in the rate of monetary expansion will result in the slower growth in real output in the short run.

In the short-run, fiscal actions are believed by monetarists to exert little lasting influence on nominal GNP expansion and therefore, have little effect on short-run movements of output and employment. It is argued that government expenditure financed by taxes or borrowing from the public tends to crowd out over a fairly short period of time, an equal amount of private expenditure, either by interest rate and price changes or by credit rationing (Sargent & Wallace, 1981). Friedman (1965) recommends that the monetary authorities merely increase the money supply by a small percentage each year to accommodate growth in the economy.

In order to attain a reasonably stable price level over the long-run, we must adopt measures that will lead to growth in the stock of money at a fairly steady rate roughly equal to or slightly higher than the average rate of growth of output (Friedman, 1965)

A basic point common to the Keynesian and the Monetarists analyses is the view that in the short run, the economy's output and variations in the output must be explained in terms of total expenditure and changes in expenditures. The crucial difference between them centres on the issue of what causes changes in expenditures? In the Keynesian model, changes in expenditure (i.e. Aggregate Demand) may be brought about by a variety of factors, including autonomous shifts in the consumption function, increases or decreases in investment due to interest rate changes, tax and public expenditures. But in Modern Monetarist theory, quantity of money is the key variable; change in money supply more than any other kind of change explain changes in money income, real output (in the short run) and the price level.

If output can be expanded, then the increase in money expenditures triggered by an increase in the money supply may expand both output and employment. But if output cannot be expanded, then money changes will only affect the price level and not real values. The Monetarists reject the Keynesian notion that consumption function, the investment demand schedule, or the combined transactions and asset demand for money function may shift exogenously and thereby cause changes in output and employment. Rather, the Monetarists are of the view that changes are exogenous, triggered by prior changes in the quantity of money. To them, monetary influences are much stronger than fiscal ones-tax and public expenditure changes in affecting the general level of economic activities.

Most Monetarists regard a market economy as a clear and orderly place in which the price mechanism working through the incentives signaled by price changes in competitive markets achieves a more optimal and efficient outcome than could result from a policy of government intervention. They believe that risk-taking businessmen or entrepreneurs, who will lose or gain through the correctness of their decisions in the market place, "know better" what to produce than civil servants and planners employed by the government on risk-free salaries with secured pension. Provided that markets are sufficiently competitive, what is produced is ultimately determined by consumer sovereignty, with consumers knowing better than government what is good for them. According to this philosophy, the correct function of government is to reduce to a minimum its economic activities and interference with private economic agents. Thus, as Powel (1989) puts it, "government should be restricted to a night watchman role, maintaining law and order, providing public goods and offering other minor corrections when market fails, and generally ensuring a suitable environment in which wealth creating entrepreneur can function in competitive markets subject to minimum regulations".

This philosophy of correct role of markets and of government led most monetarists to reject discretionary intervention in the economy by the government as a means of achieving goals such as reduced unemployment. Monetarists believe that at best, such intervention will be ineffective; at worst it will be damaging, destabilizing and inefficient. Instead, monetarists prefer that government should adopt if necessary,

by law, fixed automatic policy rules. To ensure against the use of discretionary fiscal policy to manage demand, and also to assist the "hitting" of money supply target, monetarists have recommended that fiscal policy should be based, on a fiscal rule to balance the budget or perhaps to reduce the deficit to a fixed proportion of GDP. Monetary policy should in turn be based on monetary rule to expand the money supply in line with the growth of real GDP in order to control inflation.

Thus, the monetarist's policy advice contrasts very sharply with the Keynesian advice. It is "keep the money supply growing at a constant known rate each and every year, no matter what the level of output is" (Miller, 1983). If output is below its full employment level so that there is a recession, monetarists advice holding the money supply on a steady course that is known and predictable, rather than raising the rate of growth of the money supply above that known and predictable path. Conversely, when the economy is in a boom with output above its full employment level, the monetarist advice is again hold the money supply growing at a steady and predictable rate rather than to reduce its growth rate. Accordingly, the monetarist fiscal policy advice is that government expenditures should be set at a level that is determined with reference to the requirements of economic efficiency rather than with reference to macroeconomic stability.

Monetarist have at times recommended an exchange rate rule though distinction can be made between monetarists who recommended a 'floating exchange rate' rule and those who believe in the virtue of a 'fixed exchange rate' rule.

On monetary transmission mechanism, modern monetarists, like their classical predecessors believe that linkages between the money supply and nominal National Income are strong and direct. Monetarists perceive the demand for money as stable, so an expansion in the money supply is viewed as generating surpluses of money in the hands of consumers and investors. These surpluses of money, when spent, quickly increase aggregate demand. Consequently monetarists predict that in the long-run growth in the money supply will be translated strictly into higher prices even if monetary expansion occurs during recession. Expansionary macroeconomic policies will however induce greater output more quickly in the midst of a recession.

Most modern monetarists oppose active monetary policy to combat recessions De Haan and Zelhorst (1990:455-469). They view long-run adjustments as fairly rapid, believing instead that deflation will quickly restore an economy to full employment. An even greater concern is their fear that discretionary monetary policy might "Overhshoot" causing recession to move into inflation. According to this monetarist line of thinking overly aggressive monetary expansion can eliminate recession and unemployment more quickly than "does nothing" policies but only at the risk of sparking inflation.

2.2 Concept of fiscal deficit

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. However, to underline the seriousness of the fiscal imbalance, many brands of 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 in positive the current balance is in surplus;
ii. Primary balance: Primary balance 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: The overall balance 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: The cyclical deficit is the portion of the deficit that results from an economy being at a low level of economic activity; and
v. Structural deficit: This defines the portion of the deficit that would exist even if the economy was at its potential output. A structural deficit is not directly attributable to the behaviour of the economy

and is part of the deficit for which policy maker are responsible. In other words, it is the result of decisions policy makers have made about tax rates, the level of government spending and benefits levels for transfer payment (Oke, 2000).

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.

2.2.1 Causes of fiscal deficit in Nigeria

1. Political considerations

It is important to note that we cannot separate politics 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 citizens 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.

2. 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 mono culture (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.

3. 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, 2000).

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

1. Domestic sources

Under domestic sources, fiscal deficits could be financed through the banking system or the non-bank public. According to Onoh (2007:89), “Domestic sources for financing government deficits include the following:

a) the use of accumulated cash balances;
b) borrowing from individuals and firms;
c) borrowing from non-deposit financial institutions such as insurance companies and the Social Trust Fund;
d) borrowing from statutory bodies, corporations, states and local governments;
e) borrowing from deposit-financial institutions such as the deposit money banks and other savings-type institutions;
f) borrowing from money and capital markets;

g) borrowing from the Central Bank of Nigeria".

We begin first, with borrowing through the banking system. 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 is banker to the Government. Above all, there exists the legal provision for temporary accommodation of Government finances by the 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 ways and means advances is an over-draft 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 instruments. 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 stocks/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, (CBN, 1993) 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).

2. 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 Acceptance (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 th clearance and guarantee of the Nigerian Federal Government. But during the second Republic between October, 1979 and December, 1983, State governments were known to have borrowed straight from the World financial markets without the knowledge of the Federal Government. The uncontrolled borrowing by State governments 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 macro-economic 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).

2.3 Fiscal policy in Nigeria

Fiscal policy has been applied to refer to those activities of general finance, which have to do with the reduction of economic instability and the stimulation of employment and long term economic growth and development. It is an articulated framework detailing how fiscal policy instruments can be varied by government to influence the long term growth and development of the economy, especially the growth rates of employment and national income (Onoh, 2007). The two main fiscal policy instruments are the expenditures and receipts.

If the instruments of expenditure and receipts are properly synchronized with other macro-economic policy instruments from the monetary, institutional and the direct economic intervention arena, the economy becomes stabilized and the macro-economic objectives of higher levels of employment, national income and balance of payment equilibrium become realized to a large extent thereby bringing about economic development.

Expenditures include the following:

(i) Government purchase of goods and services;

(ii) Transfer payments to economic units, not for services rendered. Examples of transfer payments are: disaster relief, pension, and subsidies for the benefits of farmers or depressed industries; and

(iii) Repayment of debt (domestic and foreign).

Receipts include the following:

(i) Taxes, fines, fees, royalties, investment income;

(ii) Government sales of goods and services (e.g. privatization of public sector enterprises, boarding of unserviceable vehicles and equipment, etc);

(iii) Federal Government of Nigeria contraction of new loans (domestic and external)

Fiscal authorities can influence the direction and the outcome of economic activities by varying the revenue and expenditure items of the budgetary plans. For example, taxes may be reduced to allow for more disposable income for consumption and savings. An increase in saving and consumption invariably lead to the expansion of investments and output respectively and to more employment places. In the long run government benefits more from greater revenue generated by way of direct and indirect taxes arising from the increase in employment and output.

By manipulating fiscal policy instruments (tools) such as taxes, public debt and by adjusting from time to time the pattern of expenditure, a wide variety of economic goals can be achieved. While levying taxes can be deflationary, as taxes reduce the spending incomes of economic units, financing through deficit policy is expansionary. Deficit financing has also its price. Deficit policy is intended to generate an increase in aggregate spending or the aggregate demand for goods and services by the public and private sectors. Demand for capital and consumer goods as well as services are stimulated. In the short, medium and long runs, employment and output are leveraged many folds their former levels.

It should be noted that neither balanced, surplus nor deficit budget is bad *per say*, provided that whichever is applied is directed to bring about economic stabilization and accelerated growth rate of output and employment (Onoh, 2007).

2.3.1 Fiscal policy in Nigeria under regulation

It has been observed that when the third National Development plan (1975-80) was adopted, Government revenue was at its peak in Nigeria. During that period, there was remarkable improvement in both domestic revenue and foreign exchange earnings. This subsequently led to a rapid growth in aggregate income and expenditure. Consequently, fiscal polices were geared towards checking inflationary pressures. Other policy measures adopted under the plan period were import liberalization. This was to be pursued further by relaxing all administrative controls, removing all non-tariff barriers to trade, considerably reducing import and excise duties where they were actually significant (Lambo, 1987).

At the beginning of the plan, the Nigeria economy was faced with some difficulties, especially inflation and balance of payments deficits. In order to remedy the situation, several fiscal policy measures were adopted by the Government. It then became clear that revenue, and foreign exchange earnings would become an obstacle

in the implementation of plan. Following the glut, which developed in the world oil market during the period, the volume of production and prices of Nigeria's crude oil fell substantially.

The domestic economy was also overheated as a result of the high level of aggregate demand during the review period. This was caused by increased Government expenditures completely, (Gbosi, 1993). The major objective of fiscal policy under the fourth National Development plan, 1984-85, was aimed at stimulating domestic production. In order to achieve the above policy goal, several fiscal policy measures were adopted. For example, the Income Tax Management Acts (ITMA) of 1981 and companies Tax Act of 1979 were amended by the financial Miscellaneous Taxation Provision Decree of 1985, the Decree specified the following tax policies;

1. The rate of tax deduction as revenue in respect of rents, dividends, subsides and interest was increased from 12 to 15 percent.
2. A limit of four years was set for the period during which losses incurred by companies was to be carried forward against future projects.
3. In calculating capital allowances for the purpose of tax relief, only the straight line depreciating method was used.
4. The turnover tax was abolished.
5. An airport levy of N500.00 was imposed on persons traveling to places outside Africa. It is important to state that the level was additional to the existing airport tax of N50.00
6. A levy of N500.00 was imposed on companies which after 6 months fail to commence business in the country
7. The personal income tax allowance was raised to N5000 plus 20 percent of earned income.
8. Tax clearance certificate was required in various types of transactions (CBN, 1995).

On October I, 1985, the Federal military Government declared a state of National Emergency for a period of 15 months. The National Economic Emergency Decree empowered the President to issue orders and legislation, which aim at revamping and stimulating the economy during the period of the emergency. In exercising his powers under the Decree, the president introduced two other measures. First deductions which vary from 2 to 15 percent from all incomes including rent, dividends as well as salaries and wages of employee in both the private and public sectors including the armed forces were made. The deduction was made at sources named above and paid into the Economic Recovery fund at the Central Bank of Nigeria. A committee headed by Federal Director of Budgets was set up to manage the fund, Gbosi, (1977). Secondly, the decree also banned the importation of rice and wheat. This policy action subsequently led to a substantial increase in the price of rice. Even after the Economic Emergency period, there had not been any fail in the price of rice and other basic agricultural commodities in Nigeria. Rather there was a sharp increase in the prices of goods and services in all sectors of Nigerian economy. Apart from rising inflationary pressures, mass unemployment, external sector instability, and other macro-economic problems persisted during the period, 1980-1985, Gbosi(1989).

2.3.2 Fiscal policy in Nigerian under deregulation

As in the pre-SAP period, Nigeria's major macroeconomic problems under the SAP were those of rising levels of unemployment, rising rate of inflation, huge public debt and disequilibrium in the balance of payments. To this effect, several fiscal policy measures were adopted under the SAP. Specifically, in 1990, Fiscal policy was designed to substantially reduce budget deficit, guarantee increased revenue and improve effective control and efficiency in Government fiscal operations, (CBN, 1990).

A major fiscal policy measure adopted in 1987 was the continuation of the national economic recovery fund, which was established in 1985. In the same year, these other fiscal policy measures were adopted. First the three important surcharges, which were components of 30 percent consolidated import levy abrogated on the coming into effect of the second-tier foreign exchange market (SFEM), in September 1986, were re-introduced. Secondly, the rate of companies' income tax was reduced from 45 percent to 30 percent. Thirdly, the air travel levy of N100 was abolished. However, the airport tax on international travel still remained N500. Finally, as part of measures to reduce the impact of inflationary pressures on the workers in the civil service, the Government restored and in some cases increased some fringe benefits, (CBN, 1987).

The fiscal policy measures adopted in 1988 were classified under three categories. They were:

(i) Measures to reflate the economy;
(ii) Tariff measures; and
(iii) Other fiscal measures.

In 1988, several fiscal measures were taken to reflate the economy. For example, there was a provision of reflationary package of N250 million in additions to the built-in deficit of N600 million during the fiscal year.

A lower company tax rate of 30 percent for 3 years was approved for small and medium size companies. In the case of tariff measure, a comprehensive tariff structure was adopted in 1988; it was designed to last for 7 years with a view to protecting local industries.

The other fiscal measures included the following:

(a) The 1987 personal income tax allowances were retained; and

(b) A 15 percent minimum taxation for all investment incomes (dividends, interest, royalties and rents) was adopted (CBN, 1988).

Most of the fiscal policies adopted in 1988 were retained in 1989. Fiscal polices were to combine a reliance stance with other measures which aimed at improving efficiency. During the period 1990-1993, in other to improve fiscal balance budget, certain general principles were designed to balance effectiveness of public spending. These measures included retain on growth of the Federal Wages Bill, an increase in residual subsidies to ensure adequate maintenance of infrastructure and the mobilization of subsidies to economic and quasi-economic parastatals.

As Gbosi (1995) observed, in 1992, the stance of fiscal policy was planned to be moderately restrictive. For example, the approved budget for that year was estimated to be balanced with an overall of N2.0 billion. This goal was not achieved because the fiscal operations of the Government resulted in the deficit of N4.8 billion in that year. To this effect, the Transitional Government adopted several fiscal disciplinary measures during its tenure, (August 1993-November, 1993) especially; efforts were also made to restore credibility and integrity in the budgetary process. This was to be reflected through greater fiscal co-ordination, proper management of the stabilization account as well as total clamp down on extra budgetary restraint. In addition to the above measures, a Modified Value Added Tax (MVAT) was introduced in the middle of 1993 to replace the existing sales tax (CBN, 1993). The rationale behind this policy was to shift resources from luxurious consumption to the productive sectors. Presumably, the various fiscal policy measures adopted during the period, 1990-1993, apparently did not achieve their intended objectives. Thus, there was a change in macroeconomic polices in 1994. Specifically, as announced in the 1994 budget, the Nigeria Government abandoned some of its liberalization polices in 1994. For example, macroeconomic polices were formulated under a fixed foreign exchange and interest rate regime. Under the fixed exchanged and interest rate regime, N22 was pegged to the U.S. dollar. Interest rates were also fixed by the Government (Nnanna, 2002).

According to the Government, fiscal policy and programme in 1994 would complement the objectives of monetary policy to maintain price stability and to foster reasonable growth of the real sectors. Thus in 1994, there were major changes in tax policy. Specifically the tax policy in 1994 was designed to strengthen and consolidate the benefits derived from the administrative and legislative charges in 1992 and 1993. The tax policy was aimed at the reduction of the tax burden on the low income- earners, promotion of healthy tax climate to attract and encourage local and foreign investors and to encourage investment in rural areas with a view to discouraging the rural-urban population drift.

As earlier mentioned, the newly introduced Value Added Tax (VAT) replaced the sales tax system. The VAT which is a consumption tax came into being by virtue of Decree No. 102 of 1993 and was implemented with effect from January 1, 1994. The VAT which replaced the sales tax covers 17 types of goods and 24 items of services as opposed to only 9 items that were covered by the sales tax. It is important to know that the VAT was designed to be progressive. Therefore, certain goods and services were exempted in order to reduce the burden on the average citizen. Several advantages were expected to be derived from VAT. Firstly, it would broaden the tax base, and do so with an equal burden on imports and domestically produced goods and services (Nnanna 2002).

Secondly, it would diminish the distortions to private savings and investment by shifting the incidence of taxation toward expenditure rather than income. Finally, it would promote greater flexibility in public sector revenue in the light of fluctuations in oil revenue. The macroeconomic policy measures introduced in the 1994 budget were intended to arrest the declining growth in the productive sectors of the national economy. They were also designed to check inflationary pressures and correct disequilibrium in the balance of payments. Specifically, the main policy objectives of the 1994 Budget were the promotion of self sustaining growth in the real sectors under a fixed foreign exchange and interest rates regime in addition to the tight fiscal and monetary polices.

However, developments in (1994) had shown that these objectives were not fully realized. As a result, the Government decided to adopt a policy of guided deregulation in 1995. In this regards, the major policy goal for 1995 as announced in the 1995 budget, was the deliberate build-up and strengthening of external reserves to enhance confidence in the Nigeria economy. This would subsequently strengthen the Naira and pave the way for

its ultimate convertibility. The objectives of fiscal policy as announced in the 1995 budget included the following:

a. To restore the dignity of the Naira
b. To expand agricultural production;
c. To improve capacity utilization of industries
d. To create jobs and make little more pleasure
e. To encourage exports
f. To reduce inflation; and
g. To expand revenue base and improve revenue collection.

Thus, the fiscal policy for 1995 was pursued to achieve the objectives outlined above. During the period, 1996-1998, the primary objectives of fiscal policy were to maintain an optimal balance between Government revenues and expenditures. Fiscal policy measures were also designed to promote growth in the various sectors of the economy. Furthermore, as a result of growing demand for increased Government expenditure and the increasing difficulty of increasing the tax base, efforts were geared towards improving the efficiency in tax collection. Specifically, revenue mobilization measures included tax reforms to recoup tax administration, especially taxes collection. It was aimed at the intensification of new and flexible property tax, inheritance or wealth tax and further restructuring of import tariffs. In order to reduce certain Government expenditures as a means of achieving certain mobilization for the economic recovery programme, certain measures were adopted by the Government. Most of the fiscal policy measures adopted in 1998 were also retained in 1999, 2000 and 2001 respectively (Ahmed, 1985).

In spite of the laudable fiscal measures of the Government, the economy is still in shambles. In recent years, Nigeria's fiscal operations have been characterized by huge deficits. The huge fiscal deficits need to be financed either by domestic or external resources.

Various fiscal operation tools have been put in place to ensure stability in the macroeconomic variables over the years but these efforts have not yielded any result. This to a large extent means that there are some fundamental impediments to the success of these policies which have not been researched and hence we will take a deeper look into the place of fiscal Federalism, macro-economic environment under which these polices are carried out, major policy shift of the Government and implementation pattern of these polices on the success of fiscal operations and its impact on macro economic variables in Nigeria. This will form a major departure from other works done in this area.

2.4 Fiscal federalism

Fiscal Federalism in brief can be defined as inter Government fiscal operations as enshrined in a Federal Constitution providing for the functional responsibilities to be performed by the multi-levels of Government and the financial resources that can be raised and shared for the provision of collective goods and services (Okunrounmu, 1996:37)

Fiscal Federalism recognizes that the role of the state in economic management may have to be performed by two or three Governments and not one central government as in a unitary state. In other words, fiscal federalism broadly involves the division of taxing and expenditure functions among the levels of Government in a federation. Federal system has to contend with multi-levels of government that are autonomous and interdependent.

It is important to return to the elementary and emphasize that a genuine federal constitution must derive its legitimacy from the will and authority of the people. In Nigeria's experience, the weakness of the 1979 and 1999 constitutions is simply the fact that they are products of a military Government that lacks the will and legitimacy to give a valid constitution. A genuine federal constitution is, therefore crucial in protecting the autonomy of the different levels of Government. It states explicitly the relationship with respect to the functions to be performed by each tier of Government, and the financial resources to be used. Provisions in the federal constitution can only be altered through approval by the majority of members of the National Assembly, and sometimes, supported with a public referendum.

2.5 Nigerian experience of fiscal federalism and revenue allocation

One of the central issues of budgeting under a true federal system is fiscal federalism. Put differently, fiscal federalism is a derivative of genuine federalism. The Nigerian experience of fiscal federalism has been influenced largely by the transposition of military rule. Although Nigeria retained the physical structure of

federalism, the constitution over the years remained suspended with every military take over from civilian regimes.

Fiscal federalism specify the functions to be performed by each tier of Government, provides for the financial resources to be used in supplying goods and services and demands prudence in the management of these resources in order to achieve stability and economic development. If this delicate balance is disturbed, it may result in adverse consequences for economic management and development. In Nigeria's recent history, under military rule, fiscal federalism has stunted the development of the states and local Governments and generated increasing bitterness among various communities over perceived inequity in national revenue sharing. Military Government and fiscal unitarism have created basic insensitivity to the ethics of equitable revenue sharing and the current experiment in democratic rule must correct this unhealthy situation. The imperative of the federalism and its correlate of fiscal federalism are basic national questions (Tom-Ekine, 2004).

Contending issues in fiscal management and fiscal federalism in Nigeria fiscal management is the principles, institutional arrangement flows, and techniques that govern the budget process and define fiscal relations between levels of Government. Economic and fiscal powers are being reallocated vertically, among levels of Government, horizontally, between the executive and the legislature and within the executive, among ministries. Two crucial and interrelated features of fiscal management which to a large extent determine the outcome of fiscal policy and the allocation of Government resources are:

i. The intergovernmental fiscal relations; and
ii. The structural, technical and institutional aspects of the budget System. These two aspects of fiscal management can hardly be separated. Streamlining intergovernmental fiscal relations is essential to improving financial accountability and budgeting. Improving the quality of budgeting techniques and strengthening institutional capacity are essential. Revenue sharing has been a knotty issue in the Nigerian polity before and after the country gained independence in 1960 and this has resulted in a power struggle between the Federal government and the States. The former has succeeded in capturing the major sources of public revenue but because of the large spending needs of the States, it has obliged to handover some of the money on to them. While this has preserved political dominance, the Federal Government has not escaped criticism. From time to time, State Governments have found the resultant system arbitrary, the Federal government but also at each other, Oshisami and Dean (1984). Several authors and analysts have written and suggested that one way to come out of this dilemma would be for the Federal Government to transfer tax-raising powers over its principal sources of revenue to the States. This solution has not found favour because it would:

a) Weaken the power of the Federal government,
b) Result in an uneven distribution of revenue resources, creating very rich and very poor States,
c) Encourage the break-up of the Federation.

Another way would be for the Federal Government to use its own revenue to undertake the lion's share of the expenditure in the States. Thus, the need for allocating Federal revenue to the States would be greatly reduced and States would spend only in accordance with their own direct sources of revenue. The objections to this solution are that:

a) The Federal Government does not have the administrative machinery in the States to undertake work on this scale.
b) The States are the best judges of their own expenditure needs and are equipped to handle them.
c) Federal expenditures in the States on this scale would defeat the idea of a Federation. The Constitution allocates to the States certain areas of activities and the States must be provided with the funds to undertake these activities.
d) States are better able than the Federal Government to act as a focus for local democracy. Local democracy is not possible without responsibility for local policies and accountability for local expenditures.

To overcome the above challenges and those of the past, the Okigbo Commission of 1980 (The 'Okigbo' Report), the Presidential Commission on Revenue Allocation recommended that the Federation Account be shared as follows:

Federal Government	-	53%
State Governments	-	30%
Local Government Councils	-	10%
Special Fund	-	7%

In January 1980, a Bill was passed by the National Assembly for the division of the Federation Account as follows:

Federal Government	-	55%
State Governments	-	35%
Local Government Councils	-	10%

In order to ensure that the provision of the Act are observed, the Act also provide for the setting up of important committees:
(a) Federation Account Allocation Committee (FAAC), the functions of which are to ensure that allocation made to the States from the Federation Account are promptly and fully paid into the Treasury of each State on the basis and terms prescribed by the Act, and also to report annually to the National Assembly.
b) State Joint Local Government Account Allocation Committee (SJLGAAC), of which there would be one for each State, with the function of ensuring that the statutory allocations to the Local government councils from the Federation Account and from the States' own revenues are duly made to the State Joint Local Government Account and distributed in accordance with the provisions of laws made by the House of Assembly of the State.

All attempts to bring about a revenue sharing formula that will meet the yearning and aspirations of the Federation proved abortive. In the light of this, the Nigerian authorities decided to adopt a flexible approach with respect to revenue allocation formula. The new approach will from time to time take into consideration the economic, social and political vagaries of the Nigerian environment in recommending or reviewing the revenue allocation formula. Accordingly, a permanent Commission known as the National Revenue Mobilization Allocation and Fiscal Commission (NRMAFC) was set up in 1989, as opposed to the ad hoc commissions of the past, which lacked continuity and were disbanded as soon as they submitted their recommendations. The main function of the NRMAFC is to advice on a revenue allocation formula which will suit the needs of the time for all the three tiers of government (Onoh, 2007).

2.6 Deficit financing and its implication for monetary aggregates

It is important to note that deficit financing usually 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 over heat the economy, thereby leading to serious macroeconomic problems. 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. 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, 2005). 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.

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. 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,

1980-1999, there were eighteen years of deficits. Specifically the deficits ranged between N58.8 million and 164.7 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 1992).

2.7 Relationship between GDP and fiscal policy

Fiscal policy may be defined as changes in Government spending (G) and /or taxes (T) designed to influence income and employment and promote price stability.

Budget surplus arises when the projected revenue is higher than the projected expenditure. On the other hand, budget deficit arises when the projected expenditure is higher than the projected revenue. Budget surplus occurs when there is an increase in taxes or a reduction in Government expenditure. A contractionary/restrictive fiscal policy (i.e. a reduction in Government expenditure and an increase in taxes) is usually undertaken to eliminate the inflationary gap.

Therefore a reduction in Government expenditure or an increase in taxes will shift the IS curve downward. This will lead to a decrease in GDP. Induced investment falls as income on GDP falls.

An Expansionary fiscal policy or budget deficit results when there is an increase in Government spending and a reduction in taxes.

The effect is to increase the GDP. According to (Onuchukwu, 1998: 42) “an expansionary fiscal policy will shift the IS schedule upwards to the right from IS_0 to IS_1 (as shown in the diagram above). The shift results in an increase in GDP/output or income from Y_o to Y_I thereby eliminating the deflationary gap". The interest rate increases from R_0 to R_1 and the equilibrium E_0 to E_I. The higher rate of interest under a "fixed exchange regime" will attract high capital in-flow. Foreign investors will now move into the country to invest. By investing in the domestic economy, more jobs are created leading to an increase in GDP/output.

2.8 Empirical review

Macroeconomics is the study of the operations of the economy as a whole Fischer and Dornbusch (1983). The focus of the analysis in macroeconomics 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 that inform such policies. 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 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 uses 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 calling for collaboration 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 measure on another must be taken into consideration in designing macro-economic policy (Okowa, 1995).

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 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.

2.9. Economic stabilization

The responsibility of the Government in any economic system, irrespective of its political arrangements is to initiate policies towards the achievement of four basic macroeconomic goals. These include price stability, maintaining full employment, achieving equilibrium in balance of payment positions and achieving sustained economic growth. The achievement of these goals can be referred to as economic stability Gbosi, (2002).

2.9.1 Objectives of economic stabilization

i. Price stability: The instability of price level apart from affecting the usefulness of money has a great adverse effect on the economy clearly. A lower rate of inflation is preferred to the higher rate, but not withstanding in measuring inflation, the question arises as to how the desired rate of inflation should be. Zero inflation may be seen to be ideal position, but in a dynamic economy, the movement of prices, and hence the allocation of resources implies that some prices would have to fall in other to accommodate rises in other prices. Now whilst this might be quite feasible in relation to the prices of certain basic commodities and even some manufactured goods, it would seem to be most impossible that prices of labour (wages/salaries) would be allowed to adjust in this way. In general many prices tend to be sticky in the downward direction, therefore, the policy issue becomes one of the deciding factors upon the level at which the downward drift in pries requires Government action.

ii. Maintaining full employment**:** Full employment is firmly established objectives for most countries. Full employment is a concept that cannot be precisely defined. It is sometime defined as employment for all persons in the maintenance of a reasonable balance between nation's foreign receipts and payment. It is an important objective for countries that transact a large part of their business in world markets.

iii. Balance of payment equilibrium**:** Balance of payment equilibrium is a major macro-economic objective which Government seeks to maintain via economic policy, although its pursuit may have adverse effect on the other policy objectives mentioned. Each tier of Government under a Federal system prepares its annual budget. However, the Federal Budget has responsibility for performing the stabilization function while state and local governments join in production of goods and services as well as income redistribution.

iv. Real economic growth: A country’s standard of living rises when its economy grows. If the economy grows, the income of the citizens will be bigger. Also when the total output of goods and services increase, the additional output or surplus can be used to alleviate poverty.

v. Equitable distribution of income**:** The goal of equitable distribution of income becomes more important as a society grows richer. Nigeria is a good example. Some people live in affluence; yet many remain so poor that they have difficulty in buying the basic necessities of life such as foods, clothing and shelter.

2.10 The federal budget

The federal budget by its scope and objectives can be regarded as the national budget. Economic policy measures that are adopted in the Federal Budget affect both state and local Governments in the country as well as the people as a whole. The objectives of the Federal budget are aimed at influencing positive changes in the economy as a whole and the choice of economic policy and priority given to policy goals / objectives are dictated by problems facing the economy and the need to find solutions to them.

The macroeconomic objectives of fiscal management in Nigeria have always included price stability, real economic growth, full employment and balance of payments equilibrium. Incidentally, macro-economic theory does not regard accountability and transparency as economic objectives. These two conditions are implicitly assumed as necessary conditions of efficiency and are taken care of by a sound budget process Agiobenebo (1999). The budget process consists of four cycles or phases and these are:

(i) Preparation of the budget

The executive prepares the annual budget and submits to Parliament. The draft budget is published and given wide publicity in the media. It is also a condition of the budget process that in presenting as a draft budget to Parliament, details of actual expenditure of the proceeding year's budget must be submitted to the Parliament.

(ii) Approval of the budget

The parliament approves the budget proposal by the Executive. Parliament has power to modify the draft budget presented by the Executive, especially in the areas of tax rates, tax structure, expenditure level and structures, etc.

(iii) Implementation of the budget:

The Executive implements the approved budget. If there is need for modifications or changes in the budgetary proposals, the Executive must return to Parliament for approval or authorization.

(iv) Audit & control:

The Executive must present a detailed report of actual budget, prepared by the office of the Accountant General of the Federation to the Parliament. On the other hand, the Auditor-Genera! of the nation must also prepare an independent report of actual budget implementation to the Parliament as a check and balance on the Executive. Any difference between the two reports must be reconciled by Parliament while wrong doings by any official of the Government with respect to budget disbursement would be punished in accordance with the law (Okowa, 1995).

3.0 Research method

The research design adopted in this research work is both descriptive and analytical. In the descriptive method, the cross-sectional survey is being used. This method is suitable because it enables us to know how Government fiscal operations have affected macro-economic stability in Nigeria. The analytical method is used for the purpose of determining variations in dependent variable as a result of changes in the independent variables.

In a bit to bring about a better understanding of this study, we consulted a number of related materials. Most of the required data for this study were obtained from the Central Bank of Nigeria (CBN) statistical bulletins, published articles, journals and newspapers.

The technique adopted in obtaining information for this study relied much on intensive library research. Thus, this study relied heavily on secondary information such as published journals, texts, paper presentations, reports of Commissions and internet materials.

3.1 Model specification

The econometric model for the research study as stated below will be used to test for possible relationship between the dependent variables and independent variable**.** The study will be guided by the following models.

GDP = f (GBDF, UNP, INF, BOP, GEX, GTR)

Where:

GDP = Gross Domestic Product

GBDF = Government Budget Deficit Financing

INF = Inflation
BOP = Balance of Payment
UNP = Unemployment
GEX = Government Expenditure
GTR = Government Tax Revenue

Both linear and log linear specification were tried and the one that best suit our specifications was chosen based on goodness of fit, precision of estimates and tolerable level of multicollineariry.

4.1 Data presentation

Table 1: Data of major variables of the study

Years	GDP(N'm)	GBDF(N'm)	UNP(m)	INF(N'm)	BOP(N'm)	GEX(N'm)	GTR(N'm)
1980	50848.6	1975.2	256623	20.9	2402.2	14968.5	15233.5
1981	50749.1	3902.1	188438	7.7	-3020.8	11413.7	13290.5
1982	51709.2	6104.1	106496	23.2	-1398.3	11923.2	11433.7
1983	57142.1	3364.5	112588	39.6	-301.3	9636.5	10508.7
1984	63608.1	2660.4	121345	5.5	354.9	9927.6	11253.3
1985	72355.4	3039.7	97234	5.4	-784.3	13041.1	15050.4

1986	73061.9	8254.3	85634	10.2	159.2	16223.7	12595.8
1987	108885.1	5889.7	145610	38.3	-2294.1	22018.7	25380.6
1988	145243.3	12160.9	167453	40.9	8727.8	27749.5	27596.7
1989	224796.9	15134.5	133675	7.5	18498.2	41028.3	53870.4
1990	260636.7	22116.6	111654	13	5959.6	60268.2	98102.4
1991	324010	35755.2	100235	44.5	-65271.8	66584.4	100991.6
1992	549808.8	39532.5	123564	57	13615.9	92797.4	190,453.20
1993	697090	107735.3	187564	72	-42623.3	191228.9	192769.4
1994	914940	70270.6	102345	29	-195316	160893.2	201910.8
1995	1977740	-1000	123564	8.5	-53152	248768.1	459987.3
1996	2823900	-37049.4	154373	10	1076.3	337217.1	523697
1997	2939650	5000	163264	6.6	-220675	428215.2	582811.1
1998	2881310	133389.3	184239	6.9	-326634	487113.4	463608.8
1999	3377330	285104.7	169846	18.9	314139.2	947690	949287.9
2000	3291700	103.8	194576	12.9	24729.9	701.1	1906.2
2001	3443100	221	213456	14	-565353	1018	2231.6
2002	3562800	301.4	234568	15	162839.7	1018.2	1731.8
2003	3927600	202.7	245678	15	1128379	1226	2575.1
2004	4102152	172.6	1234567	17.9	1364846	1426.2	3920.5
2005	4721547	161.4	3432564	12.5	1246613	1822.1	5547.5
2006	5472613	172.5	4231674	22.9	134256.6	2034.6	654.87
2007	5936475	187.9	4765432	16.8	1356755	3589.9	876.98
2008	6124531	234.6	5347865	17.46	1234568	6456.8	1098.98

Source: CBN Annual report and statement of account, 2009

GDP= Gross Domestic Product; GBDF=Government Budget Deficit Financing; UNP=Unemployment; INF= Inflation; BOP= Balance of Payment; GE= Government Expenditure and GR= Government Revenue.

Table 2: Regression results of the relationship between budget deficit financing and gross domestic product

DEPENDENT VARIABLE: Gross Domestic Product (GDP)

Variables	Estimated Coefficients	Standard Error	T-Statistic	P- Value
Constant	40.280	13.280	7.033	.000
GBDF	-.187	.086	-2.152	.000
INF	.179	.062	2.864	.000
BOP	-.121	.040	-2.956	.000
UNP	-.354	.120	-2.946	.000
GEX	-.235	.099	-2.363	.000
GTR	.093	.026	3.527	.000

R	=	0.996
R-Square	=	0.992
Adjusted R-Square	=	0.990
SEE	=	4.183
F – Statistic	=	80.234
Durbin Watson Statistic	=	1.948

Source: Researcher's Estimation, 2012

4.1 Analysis of data

It could be seen from Table 4.1 that GDP witnessed a differential increase of (0.20), 1.89, 10.51, 11.32, 13.75, 0.98, 49.03, 33.39, 54.77, 15.94, 24.31, 69.69, 26.79, 31.25, 116.16, 42.78, 4.10, (1.98), 17.22, (2.54), 4.60, 3.48, 10.24, 4.44, 15.10, 15.91, 8.48, and 3.17 percent from 1981 to 2008 respectively. GDP growth rate was negative in 1981, 1998 and 2000.

Government budget deficit financing (GBDF) witnessed a 97.55% differential decrease in 1981 from the previous year. This further dropped to 56.43% (N3, 902.1-N6, 104.1-:-N3, 902.1*100) in 1982. GBDF witnessed a negative increase (that is a decreasing value from their previous years) in 1983, 1984, 1987, 1994, 1995, 1997, 2000, and 2003 to 2006. The highest value for GBDF was in 1999 when GBDF was N285, 104,700.

The next variable in table 4.1 above is unemployment (UNP). From the table, unemployment (UNP) stands at 256,623 persons in 1980; this dropped to 188,438 persons in 1981 and further dropped to 106,496 persons in 1982. This value however appreciated in 1983 when unemployment increased to 112,588 million persons and 121, 345 million persons respectively for 1984 and 1985. The number of unemployed persons decreases again in 1986 and 1987. From 1988 to 2008, the unemployment rate has continuously witnessed an increase with the highest level of unemployment registered in 2008 with about 5,347,865 persons.

Inflation rate in Nigeria in the period under study was almost double digit except in 1981, 1984, 1985 and 1989 when inflation rates were single digit. The highest inflation rate was observed in 1993 when inflation rate was 72 percent.

Between 1980 to 1985, the country witnessed a highly fluctuated balance of payment position from N2, 402,200m to N784.3m Balance of payment witnessed little improvement between 1986 to 1990. This ascended from N159.2million 1986 to N13, 615.9million in 1992. The balance of payment further deteriorated from 1993 till 2002 when BOP recorded a positive value. This trend however continues till 2008.

Government expenditure (GE) in the period under study witnessed a steady decrease from 1980 till 1984 when these figures stood at N14, 968.5million and N9, 927.6million respectively. This however picked up again from 1985 to 1999. During the democratic period, government expenditure has however been very small.

Finally, table 4.2 shows the Regression results of the relationship between budget deficit financing and GDP. The regression results showed that the estimated coefficients of the regression parameters have both positive and negative signs and thus conform to our a priori expectation. The implication of these signs are that the dependent variable GDP is influenced by GBDF, INF, BOP, UNP GEX and GTR. This means that an increase in the independent variables will bring about credibility in the dependent variable.

The coefficient of determination R-square of 0.992 implied that 99.2% of the sample variation in the dependent variable GDP is explained or caused by the explanatory variable while 0.8% is unexplained. This remaining 0.8% could be caused by other factors or variables not built into the model. The high value of R-square is an indication of a good relationship between the dependent and independent variables.

The value of the adjusted R^2 is 0.990. This shows that the regression line captures more than 99 percent of the total variation in GDP caused by variation in the explanatory variables specified in the equation with less than 1 percent accounting for the stochastic error term.

Testing the statistical significant of the overall model, the F-statistic was used. The model is said to be statistically significant at 5% level because the F-statistics computed of 80.234 is greater than the F-statistics table value of 2.55 at $df_1=6$ and $df_2=22$.

The test of autocorrelation using D.W test shows that the D.W value of 1.948 falls within the inconclusive region of D.W partition curve. Hence, we can clearly say that there exists no degree of autocorrelation.

4.2 Discussion of findings

The finding of this study revealed that there exist a significant relationship between GDP and GBDF. This means that increase in GDP will certainly lead to improvement in the situation of the country as could be measured by GBDF. This finding is in agreement with the finding obtained by Edwards, (1990) who found out that an increase in government expenditure as seen in the case of government budget deficit financing will leads to a corresponding increase in GDP. This finding is also in agreement with the finding arrived at by (Jaspersen et al, 2000), who found that there exist a direct and significant relationship between the GBDF and the growth of the country as measured by GDP.

The finding of this study also revealed that there exist an inverse significant relationship between UNP and GDP in Nigeria. This invariably means that an increase in UNP will leads to a corresponding decrease in the level of GDP in Nigeria. This result is highly supported by the findings of Gbosi, (2002) who found out that when unemployment is not properly managed, it leads to drastic reduction in the GDP of the country. The

finding is also in line with the finding arrived at by Kinoshita (2006) who found out that decrease in the rate of unemployment through deficit financing significantly increase the rate of GDP in the country.

The finding of this study also reveals that there exist a significant relationship between INF and GDP in the country. This finding is in agreement with the finding of Asante (2002), who noticed that there exist a significant relationship between inflationary rate and the level of GDP in the country. To him inflation helps to pump much money in to the economy thereby increasing the prices of goods and services.

One of the finding of this study also revealed that there exist an inverse relationship between BOP and GDP. This implies that when balance of payment decreases (BOP deficit), GDP will increases and vice versa. This finding is in line with the finding arrived at by Asiedu (2002), who in his study noted that balance of payment most often comes as a result of the inability of the government to balance its account thereby having a balance of payment deficit. As such the wider the deficit gap, the larger the extra money government will source to balance the account.

The finding of this study also revealed that there exist a significant relationship between government expenditure (GE) and GDP). This finding is in agreement with the finding arrived at by Akinkugbe, (2003), who found out that there exists a significant relationship between government expenditure and GDP. According to him, government expenditure means increasing GDP. This finding is also in line with the result obtained by Adam and Bevan (2005), who discovered that government expenditure has an inverse relationship with GDP.

The finding of this study revealed that there exist a direct relationship between government revenue and GDP. This finding is in line with the finding obtained by Okunrunmu (1998) who discovered that GDP arises when government revenue is higher.

5.0 Conclusion/Recommendations

5.1 Conclusion

Based on the findings obtained from the study the, following conclusions were made. Government budget deficit financing significantly influence economic growth and development in Nigeria. This could be seen from the evidence of a corresponding increase in GDP and a reduction in unemployment rate when government budget deficit financing increased.

Also, government budget deficit financing is frequently used to check macroeconomic instability in the country. For example when government revenue drops, the alternative measure taken to remedy the situation is government budget deficit financing. Equally, when balance of payment is negative (deficit), government budget deficit finance could be used to stabilize the balance of payment.

5.1 Recommendations

Based on the findings of the study, the following recommendations were made:

1. That Budget deficit should not be used as a tool for promoting or bringing about economic development.
2. That government should embark on reforms on tax administration of the country. Especially reforms geared towards the introduction of new taxes or improvement of yield from existing taxes.
3. The government should be accountable to the electorates by forestalling transparency in the preparation & implementation of budgets. Thus, a system of sound internal control mechanism should be put in place to facilitate early detection of fraud in the budgetary process. Those indicted in the process should equally be brought to book promptly by the law enforcement agencies like the Economic & Financial Crime Commission (EFCC), Independent Corrupt Practices Commission (ICPC), the police, etc.
4. The significant figure showing deficit shows that most times, fiscal authorities' under-estimate the cost of items in the budget. Excessive deficit spending is occasioned by inappropriate planning and evaluation caused by the inexperience of economic planners. Also, government attitude of lack of transparency could be a major cause. Hence, the government should exhibit a high degree of transparency in governance so as to bring to the barest minimum deficit financing.
5. To avoid what is called "blind" budgeting, call circulars from the Ministry of Finance to ministries requesting the submission of budget proposals should give adequate guidance on the government's priorities for expenditure, resources likely to available, and the prospective ceilings of expenditure

estimated for various ministries and functions. Hence, budgets should be prepared with reference to targets and goals, they should be linked with implementation and subsequent performance review.

6. The system of budgeting should reflect the nature and time-span of the decisions being made. Thus, the constitutional requirements for budget formulation for a period of one year should be reconsidered due to its short-sighted view of waiting till the last minute for budget compilation. The annual budget should be framed within the context of medium and long term budget covering a period of years into the future.

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