Fiscal Deficit And Economic Growth, Nigeria Experience

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Abstract

This study examines impact of fiscal deficit on the growth of Nigerian economy using co-integration and error correction. Secondary data were gathered from various sources such as; the Central Bank of Nigeria statistical bulletin, economic and financial review monthly and annual reports and statement of accounts for various years. The time series property of the data employed, are first to be investigated. This is then followed by testing for co-integrated variables. From the unit root test, the results clearly indicate that the variables are integrated of the same order at first difference. Also, from the multivariate co-integration test, within the Auto-Regressive Distributed Lag (ARDL) the results indicate that there are, at most, two co-integrating vectors. This implies that there exists a stable long-run relationship between economic growth and budgeting components. From the study, it was discovered that deficit budget is one of the indicators of macroeconomic instability and significantly discourage human capital accumulation. However, recommendations are made based on the findings among which are that government should set its priorities right, be more committed to budget implementation and to pay more attention to capital expenditure geared towards growth.

Introduction

According to the public finance literature, "a budget deficit is the excess of government outlays over receipts taken in from taxes, fees and charges levied by government authorities" (Hyman, 1996). The budget deficit measure is used to assess the sustainability of fiscal policy. A budget deficit suggest an expansionary stance. The budget deficit as a percent of GDP is an indicator of the changeful impact of the government sector on the economy.

Fiscal deficit is generally defined in terms of loan financing and drawing down of cash balances. It therefore, connotes the difference between the budget receipts and budget expenditures financed by withdrawal of cash balances and borrowing from the public (Nwaogwugwu, 2005).

Faith and Yunus (1990) "the term of fiscal deficit can be defined as the difference between revenue and budget expenditure. Budget revenue includes three important components which are tax revenue, tax-exempt revenues and private revenues. The most important component of the budget revenue is tax revenue. However, budget expenditure involves four important elements. These are: current expenditure, investment expenditure, real expenditure and transfer payments. Current expenditure is a kind of expenditure which is related to non-durable goods. It is usually used for short term expenses. Investment expenditure is stated as expenses related investment and efficient use of resources. Transfer payment is an unrequited payment that has an indirect effect on GDP. Real expenditure consists of production factors and production expenditure. If budget deficit shows the disharmony and imbalance between revenue and expenditure, both the revenue and expenditure side of budget should be analyzed in detail".

Onwioduokit (1994), "Fiscal deficit arise because public spending rises while revenue remains unchanged, or tax revenue fails while public spending remains unchanged, or tax revenue falls while public spending rises. A commonly observed phenomenon in most developing countries is that, the public sector plays a dominant role

in initiating and financing economic growth. The resultant growth in public spending is expected to be financed by public revenues from taxes and non tax sources but the revenues always lag behind the level of public spending, leaving large deficits in the focus. The growth in public revenue in developing countries are restricted by many factors such as: low per capita income, limiting the base on which direct taxes can be imposed, income tax exemptions in the form of tax holidays, accelerated depreciation rates and tax credits usually provided to the manufacturing sector, and deficiencies in tax administration. On the other hand, public spending continues to grow due mainly to mismanagement; increased public participation in production and control of economic variables; and inability to control spending.

However, despite the fact that Nigerian Government had had various deficit budgets to stimulate Economic Growth yet less is achieved in the respect. One of the primary objectives of budgetary is to achieve a sustainable Economic growth.

It is no exaggeration to claim that Nigeria's huge debt burden was one of the hard knots of the Structural Adjustment Programme (SAP) introduced in 1986 by the Babagida administration. The high level of debt service payment prevented the country from embarking on large volume of domestic investment, which would have enhanced growth and development. With the debt forgiveness granted to Nigeria, one would expect the economic process of the country to be increased. However, with the number of years of independent and the substantial debt she has incurred, coupled with the existing situations, one can claim that the entire spectrum of the economy has not been sufficiently active, deficit sustain these negative consequences with their rippled cost over a long period of time beyond the point even the deficits stopped. Ongoing fiscal deficits substantially reduce national savings, consequently domestic investment. The effect is increased foreign borrowing, beyond their sustained budget deficit can also erode confidence on the economy both locally and internationally.

Deficit borrowing naturally in additional monetary injection into the system irrespective of how is financed. The rapidly expanding money stock artificially lowers interest rates, and causes it to deviate from the path dictated by voluntary savings, thus signating investors to invest in longer term and more capital intensive projects. However, this artificial inferred interest rate do not reflect consumers time preference Generally what budget deficit does is to increase the spending usage of government and at a second level when the money has been spent on the public and private consumption and investment will increase. In the short run however, consumption and investment remain substitutes meaning that more consumption can only yield less investment and vice versa.

However, the rest of the paper is structured as follows, section 2 contains the conceptual issues, section 3 presents the theoretical framework and research method, Section 4 discusses the findings while section 5 concludes the paper.

Section II

Conceptual Issues

Conceptualization of Government Budget and Fiscal Policy

Jhingan (2008) define fiscal as a policy under which the government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment. Though the ultimate aim of fiscal policy is the long-run stabilization of the economy, yet it can only be achieved by moderating short-run economic fluctuations (Jhingan, 2008). Fiscal policy is the economic term which describes the actions of a government in setting the level of public expenditure and the way in which that is funded (Valmont,2006).

The term fiscal policy has conventionally been associated with the use of taxation and public expenditure to influence the level of economic activities. Fiscal policy through variations in government expenditure and

taxation profoundly affect national income, employment and output. Government can control deflationary and inflationary pressures in the economy by a judicious combination of expenditure and taxation programmes(Jhingan, 2008). The most important instrument of fiscal policy in literature is the budgetary (contracyclical fiscal policy). It (budget) both reflects and shapes a country's economic life (Omitogun and Ayinla 2007) and is used as a tool in the management of a nation's economy (Jhingan, 2008). In designing and implementing fiscal policy, government plans for budget deficit, budget surplus or balanced budget

Budget Deficit: Expansionary Fiscal policy

Budget deficit is the type of budget in which government expenditure out weights its revenue. When there is economic recession or depression, government plans for budget deficit which is often referred to as expansionary fiscal policy. In this situation, taxes (i.e. compulsory levies imposed by the government on individuals and corporate bodies) are reduced and government expenditure is increased. The implication of this is that by reducing taxes, the purchasing power of individuals is enhanced and the cost of production by corporate bodies reduces thereby improving their scale of operations. Similarly, increases in public expenditure if efficiently utilized could translate into improved infrastructural development and consequently enhance general welfare and also put the economy on the path of growth.(Omitogun and Ayinla, 2007).

Section III

Methodology

Theoretical Underpinning of the Study

The fundamental structure of the economic growth model in this study is adopted from the theoretical framework of AK endogenous growth model. The AK model is a linear production function that is adaptable to address the problems of economic growth in developing economies. The model incorporates channel through which budgetary components can affect long run growth rate in an economy. it transforms the temporary growth effect of budgetary components implied by the neo-classical model into permanent growth effect and hence, growth rate (Barro and Sala-i-Martin, 1992).

The below model is a special case of cob-Douglas production function:

$Y = AK^{\alpha}L^{1-\alpha}$ ----------1

Where

Y = Output

A = Total Factor Productivity

K = Capital

L = Labour

α = a parameter between 0 and 1

For the special case in which $\alpha = 1$(and by dividing eqn 3.1 by L), the function becomes:

y = Ak (Hence the Ak model) ----------2

Where:

y = Per capita output

A = Level of technology which is a positive constant

K=Physical and human capital (per capita)

Various extension of the basic Ak endogenous growth model fiscal policy have been worked out, allowing different forms of expenditure to be productive (e.g. Devarajan, Swaroop and Hengfu (1996); Sala-i-Martin

(1997); Glomm-Ravikumar (1997); Kaganovich-Zilcha (1999); Zagler-Durnecker, (2003); Gomez, 2008), and various forms of taxation (Ortigueira, 1998).

Barro (1990) provided an interesting extension of endogenous growth models to include government taxation and spending but with a specific limitation that was corrected by Kneller, Bleaney and Gemmell (1999), Bleaney, Gemmell and Kneller (2001), Daniel and Oliver (2005) and Nikos (2009). Let us discuss the mechanism through which fiscal policy influences growth within the context of the Barro (1990) and Barro and Sala-i-Martin (1992) models that provide a long term growth endogenously. The model assumed that there were 'n' producers in the economy, each producing output (y) according to the producing function:

$y = AK^{1-\alpha} g^{\alpha}$ ----------3

Where:

y = per capita output

A = a positive constant

K = private capital (per capita)

g = publicly provided input (per capita)

α = a parameter between 0 and 1

From above, there are constant returns to total (public plus private) capital inputs i.e. k + g. if the government balances its budget in each period by raising a proportional tax on output at rate r and lump-sum taxes (L), the government budget constraint can be expressed as:

ng + C = L + rny ----------4

Where:

n = number of producers in the economy

ng = productive government expenditure

c = government provided consumption (non-productive) goods

Theoretically, a proportional (distortionary) tax on output (r) affects private incentives to invest, but lump sum (non-distortionary) taxes (L) do not. Specifically Barro (1990) and Barro and Sala-i-Martin (1992) derived the long run growth rate (y) in this 2model as follows:

Given $y = Ak^{1-\alpha} g^{\alpha}$ ----------5

s.t,: B = ng + C + L + rny ----------6

Where B = balance constraints. Through lagrange multiplier the utility function becomes:

$y = Ak^{1-\alpha}g^{\alpha} + \lambda(B-ng-C-L-rny)$----------7

$$\frac{\partial y}{\partial k} = \alpha A k^{(1-\alpha)} g^{(\alpha-1)} - \lambda n = 0$$ ----------8

$$\frac{\partial y}{\partial k} = (1-\alpha) A k^{[(1-\alpha)-1]} g^{(\alpha-1)} = 0$$ ----------9

$$\frac{\partial y}{\partial k} = B - ng - C - L - rny$$ ----------10

Divide eqtn. 9 by 8

$$y = \frac{(1-\alpha) A k^{[(1-\alpha)-1)} g^{\alpha}}{\alpha A k^{(1-\alpha)} g^{(\alpha-1)} - \lambda n}$$ ----------11

$$y = \alpha^{-1}(1-\alpha) A k^{[(1-\alpha)-1-(1-\alpha)]} g^{[\alpha-(\alpha-1)]} - (\lambda n)^{-1}$$ ----------12

let$\alpha^{-1} = \beta(L)$----------13

Therefore, $y = \beta(L)(1-\alpha)Ak^{-1}g^{[\alpha-(\alpha-1)]} - (\lambda n)^{-1}$ ---------- 14

From equation 14, it is clear that the growth rate is an increasing function of both the productive government expenditure (g) and the non-distortionary taxes (L). it is also evident that growth rate is not affected by both non-distortionary taxes (r) and unproductive government expenditure (C). the above specification assumes that

the government balances its budget each period, an assumption that is unlikely to hold in reality especially in the less developed countries (Daniel and Oliver, 2005).

Specifically, the evidence as shown in the table above has confirmed that the assumption cannot hold for the Nigerian economy, since government budgets are not always balanced each period but rather witness budget deficits. Our empirical models therefore follow Kneller, Bleaney and Gemmell (1999) and Bleaney, Gemmell and Kneller (2001) in which they took more practical view by assuming a non-balancing government budget constraint in some periods. Taking this into account, we re-write the budget constant equation as:

Ng + C + b = L + rny----------15

Where b is the budget deficit/surplus in a given period. Since g and L are productive, their predicted signs are positive. Both C and r are hypothesized to have zero effects on growth. specifically, Kneller et al (1999) and Bleaney et al (2001) considered both fiscal variables (FCV) and non fiscal variables (NFV) in modeling. Thus, the growth equation becomes;

$$(GRO)_t = \alpha + \sum_{t=1}^{k} \beta_i (NFV)_{it} + \sum_{j=1}^{m-1} \delta_i (FCV)_{jt} + \varepsilon_{it} \text{ ----------16}$$

Where: $(GRO)_t$ is the growth rate of output, (FCV) is the vector of fiscal variables, (NFV) is the vector of non-fiscal variables, and ε_{it} are white noise error terms. In theory, if the budget is fully specified, then $\sum_{j=1}^{m} (FCV)_{jt} = 0$ because expenditure must balance revenues. To avoid this, we need to omit at least one element of FCV (say 'FCV'_m) to avoid perfect collinearity (Kneller et al, 1999). Naturally, the omitted element must be that which theory suggests has neutral effect on growth, for to select any other would introduce substantial bias in parameter estimates. Consequently, we can rewrite equation 16 in the following form:

$$(GRO)_t = \alpha + \sum_{t=1}^{k} \beta_i (NFV)_{it} + \sum_{j=1}^{m-1} \delta_i (FCV)_{jt} - \delta_m (FCV)_{mt} + \varepsilon_{it} \text{ ----------17}$$

We can then omit $(FCV)_{mt}$ from equ 17 to obtain fiscal growth equation as;

$$(GRO)_t = \alpha + \sum_{t=1}^{k} \beta_i (NFV)_{it} + \sum_{j=1}^{m-1} (\delta_i - \delta_m)(FCV)_{jt} + \varepsilon_{it} \text{ ----------18}$$

The fiscal growth equation denoted by equation 18, as specified in Kneller et al (1999), constitutes our adoptable model for this study.

Model Specification

In specifying the model, emphasis is placed on whether deficit budget has a significant impact on the rate of economic growth in Nigeria. The dependent variable is the real gross domestic product represent as RGDP which is a function of independent variables like the total capital expenditure represented as (TCE) Total Foreign debt represented as TFD, Fiscal Deficits as FDS, government revenue from oil represented as GRO. This model is formulated thus:

RGDP = f(TCE, TFD, INF, GRO)

Now economically written as:

RGDP = f(TCE, TFD, INF, GRO…U) in a linear relationship form

$RGDP = \beta_0 + \beta_1 TCE + \beta_2 TFD + \beta_3 FDS + \beta_4 GRO + U$

Where:

RDGP – Gross Domestic Product

TCE – Total Foreign debt

FDS – Fiscal Deficit

GRO – Government revenue from oil

β_0 – The intercept

β_1, β_2, β_3, β_4 are the estimation parameters
U is the error term

Section IV

Results And Discussion

This section contains the empirical result, estimate and the interpretation of the result to know the significant of each variable and the contribution to economic growth. This section will let us know if there is a long run relationship between real gross domestic product and the independent variables which are total capital expenditure, total foreign fiscal deficit and government.

Empirical Result

Table 1: AUGUMENTED DICKEY-FULLER UNIT ROOT TEST

Variable	ADF Test Statistics	5% Critical Level	Order of Remark Integration
RGDP	-6.455039	-2.9798	1(2) stationary
TCE	-8.167933	-2.9798	1(2) stationary
TFD	-5.404317	-2.9798	1(2) stationary
FDS	-6.407073	-2.9798	1(2) stationary
GRO	-4.724970	-2.9798	1(2) stationary

Table 1 above shows the result of Augumented Dickey Fuller (ADF) unit root test is presented above from the results all the variables are stationary at second difference i.e. gross domestic product, total capital expenditure, total foreign debt, inflation and government revenue from oil. Therefore, the variables are stationary at 5% critical level respectively. The basic for a unit root test (s) is to determine the stationary of any variable especially the time series variables because non-stationary series will definitely infinite variance.

Table 2: JOHANSEN COINTEGRATION TEST

SERIES: RGDP, TCE, TFD, FDS, GRO

Eigene Value	Likelihood ratio	5% critical value	1%critical value	Hypothesized No of ce(s)
0.891283	132.9776	68.52	76.07	None**
0.635690	70.84541	47.21	54.46	at most 1**
0.551997	42.57238	29.68	35.65	at most 2**
0.409066	20.09148	15.41	20.04	at most 3**
0.174283	5.362078	3.76	6.65	at most 4**

**0 denotes rejection of the hypothesis as 5% (1%) significance level.
The result of the Johansen co-integrating test presented above indicates five co-integrating equation at 5% significance level
The table above rejects the hypothesis of no co-integration vector having compared the likelihood ratio against the critical value at 5% critical value and the five roll of 5% critical value. The result gives the existence of four co-integrations in the set of normalized co-integrating co-efficient. The result is presented below:

NORMALIZED COINTEGRATING COEFFICIENT:

Table 3: ONE COINTEGRATING EQUATION (S)

RGDP	TCE	TFD	INF	GRO	C
1,000000	1.838597	-0.408223	-3042.906	-0.448329	205580.1
	(2.83798)	(0.57312)	(6071.99)	(0.55116)	

Note: Standard error in parenthesis
Log Likelihood – 1585.558

Table 3 above shows the five co-integration equations. The co-integrating equation can be specified thus:
RGDP =205580.1 +1.84859TCE -0.408223TFD + 3042.906INF-0.448329GRO
This implies that total capital expenditure and Fiscal Deficit have positive relationship with real gross domestic product i.e. A unit change in TCE and FDS will lead to 1.848597 and 3042.906 increase in real gross domestic product while total foreign debt and government revenue from oil have negative relationship with real gross domestic product i.e. a unit change in TFD and GRO will lead to 0.48223 and 0.448329 decrease in real domestic product.
The other normalized co-integrating coefficient represents the long run relationship between the dependent and independent series in this model.

Error Correction Model

The ECM is aimed at determining the dynamic relationship that exists between the variables. In the analysis carried out on Johanson table, it has been indicated that the series in the model parameterized error correction model.

Table 4: RESULT OF OVER PARAMETERIZED MODEL

Variables	**Coefficient**	**Std error**	**t-stat**	**Prob.**
C	8015.829	4500.377	1.781146	0.1025
D(RGDP(-1))	0.891059	0.171370	5.199632	0.0003
D(RGDP(-2))	-0.042666	0.076623	-0.556826	0.5888
D(TCE)	0.006210	0.032235	0.192651	0.8507
D(TCE(-1))	-0.044554	0.0473301	-0.941917	0.3665
D(TCE(-2))	0.088873	0.036691	-2.422208	0339
ECM (-1)	-1.177165	0.234795	-5.013579	0.0001

R-Square (R^2) 0.851902
Adjusted R-Squared 0.649951
Durbin – Watson Stat. 2.913366
F-statistics 4.218358
Prob. (f statistic) 0.010305
The result of the over parameterized ECM shows that ECM coefficient is correctly signed but statistically insignificant at 5% level of significance.
The coefficient of real gross domestic product lagged by one period shows a positive relationship with gross domestic product at the short run. A unit increase in RGDP(-1) will lead to 0.89105 increase in real gross domestic product which conforms with the a priori expectation which implies that real gross domestic product if maintained over time can lead to economic growth.
The coefficient of the total capital expenditure lagged by one period shows a negative relationship with real gross domestic product in the short run. A unit increase in TCE(-1) will lead to 0.044554 decrease in RGDP.

The total capital expenditure in Nigeria is not bringing growth because they are not properly implemented and monitored. Corruption also is another reason for this.

The coefficient of the total foreign debt lagged by one period shows a negative relationship with real gross domestic product in the short run. A unit increase in TFD(-1) will lead to 0.005414 decrease in RGDP which conforms with the priori expectation. The debt profile of the country is too enormous that hardly can it be fully paid in fifty years' time. We need to curb debt or channel the debt on profitable investment.

The coefficient of fiscal deficit lagged by one period shows a positive relationship with real gross domestic product in the short run. A unit increase in FDS (-1) will lead to 97.52606 increase in RGDP. FDS reduces the real value of money but the money nominal value may be enormous.

The coefficient of government revenue from oil lagged by one period shows a positive relationship with real gross domestic product in the short run. A unit increase in GRO (-1) will to 0.006728 increase in RGDP.

The ECM coefficient is negative and significant which justifies the long run relationship in the model. The speed of adjustment is 31.8%.

R-squared gives 85.2% of the real gross domestic product while the remaining 14.8% variations are caused by variables outside the model. Durbin Watson shows that there is no autocorrelation in the model. The F-statistic which is the overall significance test of the model justifies that independent variables indeed explained the independent variables since it is significant at 5% significant level, thereby supporting the reliability of R^2 estimate. However, it is necessary to proceed on parsimonious error correction model (ECM).

Table 5 RESULT OF PARSIMONIOUS MODEL

Variables	Coefficient	Std error	t-stat	Prob.
C	5567.873	3090.875	1.800390	0.0905
D(RGDP(-1))	0.859668	0.133724	6.428697	0.0000
D(TCE)	0.023375	0.028028	0.833978	0.0416
D(TCE(-2))	-0.067657	0.026373	-2.565364	0.0207
D(TFD)	0.002907	0.004008	0.725353	0.0478
D(TFD(-2))	0.03377	0.003539	-0.943398	0.0359
D(INF)	35.06630	124.1419	0.282469	0.0781
D(INF(-1))	147.8353	120.7021	1.224794	0.0238
D(GRO)	0.000185	0.003514	0.052748	0.0958
D(GRO(-1))	0.002170	0.007678	0.282620	0.0781
ECM(-1)	-0.252304	0.084677	-2.979593	0.0088

R-Squared (R^2) 0.816712
Adjusted R-Squared 0.702157
Durbin – Watson Stat. 2.788943
F-Statistics 7.129419
Prob. (f-statistics) 0.000310

From the result parsimonious error correction model presented above, the ECM coefficient is correctly signed and statistically significant at 5% level of significance. This makes the result of the parsimonious model to be better than that of over-parameterized model. The ECM equation is therefore specified in line with parsimonious model as follows:

$$RGDP = 0.859668RGDP_{t-1} - 0.067657TCE_{t-2} + 0.002170GRO_{t-1}$$

From the ECM equation above, the error correction term, which is otherwise referred to as the speed of adjustment is correctly signed which implies that about 25% of the short run inconsistencies are being corrected and incorporated into the long run equilibrium relationship. The R^2 which measure the goodness of fit of the model is given as 0.816712 which shows that about 81.6% of the total variation of RGDP is being explained and the remaining by the error term.

Discussion Of Findings

The coefficient of the intercept in both over-parameterized and parsimonious (ECM) model which is positive shows that real gross domestic product in Nigeria will be positive if TCE, TFD, FDS and GRO do not change overtime. However, the statistical insignificance of the parameters points to the fact that other factors with which real gross domestic product could be negative exists but which the model fail to adopt.

Growth rate of total capital expenditure in Nigeria lagged has negative effect on the growth of Nigeria over time. This shows that TCE over the years has impacted growth rate negatively, due to corruption in Nigeria, lack of proper budget monitoring and implementation with lack of continuity in government policies.

Growth rate of total foreign debt in Nigeria lagged has a negative impact on the growth of Nigeria over time. Though the foreign debt if properly used will have bring about sustained growth but most of the foreign debts are spent on projects that hardly make growth to occur. Therefore, foreign debt should be channeled on investment that can sustain growth.

Growth rate of government revenue from oil lagged has a positive impact on growth of Nigeria overtime. Being the only source of revenue for the country, the government must make sure that money generated from this source is well spent. Over the year's revenue generated from oil are huge income that can bring about growth but corruption and crisis is its major problem.

From the result, total capital expenditure, total foreign debt will negatively affect economic growth both in long run and short run. Inflation and government revenue from oil will positively affect economic growth in long run and short run. Generally, the result shows that proper budgets are significant for economic growth in Nigeria.

Section V

Concluding Remarks

In this paper, we set out to examine the impact of deficit budget on the growth of Nigerian Economy. The objective of the paper is achieved through the use of co-integration and error correction. From the study, findings highlighted several points of importance among which total capital expenditure, total foreign debt and over-dependence by Nigeria government on revenue from oil are among factors contributing to the high and persistence level of budget deficit in Nigeria. Also, deficit budget is one of the indicators of macro-economic instability and significantly discourage human capital accumulation. However, the following recommendations are made. Government should set it priority rights, be more committed to budget implementation and to pay more attention to capital expenditure geared towards growth.

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