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A Theoretical Review on Budget Deficit in Nigeria

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Abstract

The study empirically examined budget deficit in Nigeria. Based on the theoretical review conducted, the following findings were made: As the current account deficit worsens, it results to the depreciation of the domestic currency which may impact the economy negatively due to the inflationary pressures and thus increase interest rates. As a consequence, the cost of borrowing goes up for the government and this exerts pressure on the government budget due to high debt service and thus high deficit levels. These vicious cycles will continue again and again, and the potential spiral effects are creating anxieties in the Nigerian economy. Empirically, there is a tendency for a country's budget deficits to crowd out its domestic investment in the short run and its stock of capital in the long run. The main problem of this study is to investigate the impact of budget deficit on economic performance in Nigeria in terms of its implications on the real gross domestic product in the short run as well as the long run periods. Budget deficit has a negative and significant effect on economic growth in Nigeria. It was recommended that government should strive to mop the leakages in accrued foreign loans, eliminate room for misappropriation of borrowed funds and hence foster the influence of this resource on the economy so as to achieve better growth especially in the short-run.

Keywords: budget deficit, economic growth, GDP

1. Introduction

Nigeria's budget deficit experience dates back to 1961, and appeared justified during the immediate post-independence era, and since then till now 85 per cent of Nigeria's budget runs in deficit. Okoro (2013) stated that deficit financing arises largely because of the need to expand the economy. Governments' inability to carry out or execute capital projects most times is what births deficit, and this ignites the need for government to finance these projects either through internal borrowing, external borrowing or implementation of monetary instrument to increase the flow of fund in the economy. Over the years, a careful study of the budget structure of Nigeria since her independence indicated that fiscal deficit has been a recurring feature of the public sector financing. This is not surprising in view of the growing desire on part of the governments to provide for the demand of economic and social overheads as well as to enhance the living conditions of the citizenry.

There is the view that fiscal deficits could be a veritable tool for enhancing accelerated growth and development in a developing economy, however, this would depend on the mode of financing the deficit and the sustainability of the fiscal deficit profile. As a consequence, there is a repel effect on the economic performance of any country whom the state of its economic activities is financed through the prolonged debt from domestic/foreign countries because it frustrates sole investors due to the high interest rate. Various economic fields of thoughts have differing ideologies on the effect of budget deficit on economic growth. This includes the direct correlation of budget deficit and economic growth by Keynesian economists and the Neo-classical economists while the Ricardians see no effect.

The development of budget deficit financing is often traced to adoption of the Keynesian inspired public expenditure which Nigeria adopted to motivate economic performance. Keynes recommended deficit spending to moderate or end a recession. According to Keynes, when an economy is recording reduced unemployment, an increase in government purchases will help a market for business output thereby creating income which stimulate growth through multiplier effect encourages the demand for business output (Oladipo & Akinbobola, 2011). Isabel, Farhi, Nicolini and Teles (2013) asserted that a positive relationship exists between economic growth and fiscal deficits. A threshold is, however, needed if the benefits of fiscal deficits on economic growth are to be harnessed. The idea of fiscal deficit is good for economic growth, but the reason why it has not improved the wellbeing of the people is the method through which it is financed.

As the current account deficit worsens, it results to the depreciation of the domestic currency which may impact the economy negatively due to the inflationary pressures and thus increase interest rates. As a consequence, the cost of borrowing goes up for the government and this exerts pressure on the government budget due to high debt service and thus high deficit levels. These vicious cycles will continue again and again, and the potential spiral effects are creating anxieties in the Nigerian economy. Empirically, there is a tendency for a country's budget deficits to crowd out its domestic investment in the short run and its stock of capital in the long run. The main problem of this study is to investigate the impact of budget deficit on economic performance in Nigeria in terms of its implications on the real gross domestic product in the short run as well as the long run periods.

2. Theoretical Framework

2.1 The Neoclassical Theory

The classical economics was developed by Adam Smith and his followers. The neoclassical group of economists proposed an adverse relationship between budget deficits and aggregate output. They maintained that budget deficits lead to higher interest rates discourages the issue of private bonds, private investment, private spending and increases inflation level and creates a similar increase in current account deficits and slows the growth rate of the economy through resources crowding-out. This school of thought considers individuals planning their consumption over their entire cycle by shifting taxes to the future generations.

Budget deficits increase current consumption by assuring full employment of resources. The neoclassical maintains that increased consumption means a decrease in savings. Interest rate must rise as to bring about equilibrium in the capital market. Higher interest rates in turn bring about a decrease in private investment, domestic production and an increase in the aggregate price level. Yellen (1989) argued that in standard neoclassical macroeconomic models, if resources are fully employed so that output is fixed, higher current consumption means an equal and offsetting reduction in other forms of spending.

2.2 The Keynesian Theory

Proponents of the Keynesian theory proposed a positive relationship between budget deficit and macroeconomic aggregates. They maintained that budget deficits results to an increase in the domestic production, increases aggregate demand, increases savings and private investment at any given level of interest rate. The main argument against the Keynesian theory suggests that an increase in the budget deficits would induce domestic captivation and thus, import expansion, causing current account deficit. In the Mundell-Fleming framework, an increase in the budget deficit would induce an upward pressure on interest rate, causing capital inflows and an appreciation of the exchange rate. That will increase the current account balance. The Keynesians stated that increasing budget deficit will lead to an increase in aggregate demand and improve investor's confidence on the economy's potential, thereby fostering investments and aggregate savings which results in economic growth in the long run.

3. Literature Review

The budget in the public sector is an important government policy document and a vital tool for achieving macroeconomic objectives. Budget deficit occurs when the expected government expenditure outweighs the anticipated government revenue within a fiscal year. The budget is a platform for translating the promises of the government into policy practice by encapsulating the decisions on the country's macroeconomic strategies such as improving employment, curbing inflation, maintain favorable balance of payments and achieving better income distribution. Budget deficit can occur as a resultant effect of fiscal indiscipline. It is also an expansionary fiscal policy instrument useful to boost economic development. Fiscal deficit in Nigeria has been noted as one of the reasons for the continued pressure on the price level. It is usually financed by the Central Bank of Nigeria

(CBN) and the proportion of the CBN's credit in the total deficit financing of the government has significantly more than double over the years. This stance has led to excess liquidity in the banking system and a substantial increase in domestic aggregate demand. Possible consequences of fiscal deficit can increase the cost of production, higher interest rates, high transportation costs, increase in the price level resulting from the depreciation of the foreign exchange rate and the excessive growth in domestic liquidity.

Budget discipline generally implies the extent to which a country can stay within the budget. It can be measured by the ratio of budgetary expenditure to actual expenditure. It is very similar to fiscal discipline which is captured by the ratio of budget deficit to the gross domestic products (GDP) (Garba, 2011). Fiscal discipline is an attribute of efficient fiscal management which is a fundamental tool for economic performance of country. This has been noted to be one of the driving forces for the rapid economic transformation of the economies of South Korea and Botswana. Thus, fiscal discipline can promote economic development through reduction of wasteful public spending and corruption, which can improve the level of financial inflow in a country, as it has been noted for the case of South Africa (Schoeman, Robinson & De Wet, 2000). The budgetary processes in Nigeria is characterized by fiscal indiscipline and disrespect of budgetary procedures (Lienert & Sarraf, 2001; Garba, 2011).

The Federal budget of Nigeria is a written document that shows in monetary terms the planned (expected) government expenditure and the total revenues of the country from the two (2) major sources — oil and taxation in the upcoming year. Besides being a statement of expected revenue and expenditure, budget is also an important instrument for actualization of socio-economic policy of government for economic growth. As a planning tool therefore various governance micro and micro economic policies for long-term self-sustainable growth are normally expressed in the annual national budget. It is short-term planning instrument where government intention of tackling issues that bother on economic growth of the nation such as unemployment, inflation, interest rate, per capital income, national income (NI), redistribution of income in the society, demand stimulation measures for local products and so on are revealed.

Budget encompasses both fiscal and monetary policy measures normally categorized and presented each year under four (4) distinct headings namely; (i) review of economic performance in the immediate preceding year; (ii) total revenue and planned expenditure on capital and recurrent expenditure; (iii) total federation account revenue and other distribution to the three tier of government and (iv) proposal of fiscal and monetary policy changes. At the end of each fiscal year, assessments are normally made as to the performance of economy via implementation of the budget. The parameter used in assessing the total economic performance of the nation include (i) macro and micro economic stability; (ii) overall real growth in gross domestic product (GDP) and (iii) fiscal operation assessment to determine whether there was budget surplus or deficit.

4. Empirical Review

Some studies were conducted on this topic: Hussain and Haque (2017) studied the relationship between fiscal deficit and economic growth of Bangladesh. Using two datasets from two different sources (BBS & WB), they provided two opposite results with the help of econometric tools such as unit root test, cointegration test, error correction model. Based on BBS data covering period of 1993-94 to 2015-2016, they revealed expansionary effects of fiscal deficit on economic growth while WB data over the period 2001-2014 provided negative and significant impacts of budget deficit on economic growth.

Ramu and Gayithri (2016) examined the long run and short run relationship between budget deficit and economic growth in India. The period of study was 1970 to 1971 and 2011 to 2012 using the vector error correction estimation method. The findings however showed that budget deficit inversely affects gross domestic product, and the effective fiscal deficit enhances capital formation directly and indirectly encourages the private sector to invest more.

Arjomand, Emamib and Salimie (2016) tried to study the effect of growth, efficiency and government budget deficit in MENA selected countries in the period of 2000-2013 by using the recommended static panel models. The results indicated government budget deficit which is the dependent variable indicate positive effects on economic growth and inflation rate variables. However, the public deficit also has a negative effect on labour productivity. Moreover, the regression in which economic growth is the dependent variable demonstrated the positive impact of labor productivity index and economic growth.

Navaratnam and Mayandy (2016) examined the effect of fiscal deficit on economic growth in five South Asian countries (including Bangladesh, India, Nepal, Pakistan and Sri Lanka) with annual data over the period 1980-2014. The study results confirmed that the fiscal deficit has a negative impact on economic growth in Bangladesh, India, Pakistan and Sri Lanka, however, the evidence in Nepal was a positive impact in this period. Secondly, there were some empirical studies found some contrastive results which suggested a positive effect or non-effect of the fiscal deficit on the economic growth in the economies.

Fatima, Ahmed and Ur-rehman (2012) conducted a study in Pakistan for the period 1978-2009. The study results also pointed out the budget deficit had a negatively impact on economic growth. In a rare research in Vietnam, Van and Sudhipongpracha (2015) studied the effects of the budget deficit and economic performance in the Vietnamese economy in the period 1989-2011. However, the result concluded that the government deficits have no direct effects on the country's economic productivity and the economic growth. Their findings also showed that the foreign direct investment played an important role in support the economic productivity (and growth) in Vietnam in the study period.

Biza, Kapingura and Tsegaye (2015) done an investigative study about the effect of budget deficit on private investment in South Africa with quarterly data in 1994-2009. The study applied the cointegration and vector auto-regression technique to provide the long run and short run dynamic effects on private investment. The empirical result found that budget deficit significantly crowds out private investment in the long-run. The finding also indicated a negative impact of the budget deficit on growth because the decreasing of investment led to a slowdown in the long-term growth. The empirical result showed a two-way causality relationship between the fiscal deficit and the output in this country.

Koyuncu (2014) investigated the impact of budget deficit and money supply on inflation in Turkey from 1987 to 2013 using Granger causality test procedure. The empirical evidence indicates a bidirectional causality existing between budget deficit and inflation. Hoang (2014) examined the relationship between deficit, money growth and inflation in Vietnam from 1995 to 2012. Applying a SVAR approach, the result reveals that money growth has positive effect on inflation while deficit has no effect on money growth and inflation. Kameda (2014) analyses the relationship between budget deficits and some macros factors in the Japanese economy. The estimation result found that the real budget deficit in Japan in 2008 caused an approximately 0.39–0.63% decrease in the real GDP in this year.

5. Conclusion

This study was carried out to investigate budget deficit in Nigeria. The study concluded that the impact of budget deficit in Nigeria is in conformity with neoclassicists. The neoclassicists believed that budget deficit is negatively related with the economy which maintained that budget deficits lead to higher interest rates. It discourages the issue of private bonds, private investment, private spending and increases inflation level and creates a similar increase in current account deficits and slows the growth rate of the economy through resources crowding-out.

Lastly, the conclusion budget deficit is in consonance with the Keynesians claim that there is a positive relationship between budget deficit and growth. Keynesians stated that increasing budget deficit will lead to an increase in aggregate demand and improve investor's confidence on the economy's potential, thereby fostering investments and aggregate savings which results in economic growth in the long run. The Keynesians posited that budget deficits result in a rise in domestic production, which makes investors optimistic about the future course of the economy.

6. Recommendations

The study recommended thus:

i. Budget administration in Nigeria should ensure efficiently and effectively utilize of borrowed fund and maintain a sporadic evaluation and supervision of such project in which borrowed fund are channeled into in order to achieve a profitable return which will help in future servicing of such deficit and also stimulate and sustain economic growth.

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

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