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Economic Aggregates, Sustainable Development and Dialectics of Deficits in Nigeria

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Abstract
The dialectics of deficits in Nigeria are associated with gross domestic product, inflation, interest rates and money supply in the economy. In This study, time series relating to these variables are drawn from publications of the Central Bank of Nigeria (CBN) and National Bureau of Statistics (NBS). They are subsequently analyzed using econometric methods with a view to establishing the extent of relationship among the various variables. The analytical outcomes reveal that budget deficits are significantly related to gross domestic product, inflation, interest rates and money supply in Nigeria. To justify the subsisting deficit financing regime, it is recommended that key organs of government should uphold the strategic ideals of economic management and administration, especially budgeting objectivity, fiscal frugality and investment viability. Furthermore, the fiscal correlates of macroeconomic growth and development should be purposely directed at achieving sustainable downward movement in prices, including cost of borrowing, so as to ultimately stimulate rather than merely simulate the Nigerian economy.
Keywords: Deficit financing, Infrastructure investment, Nigerian economy

1. Introduction

Successive governments in Nigeria have always expressed intentions to invest and upgrade developmental infrastructure in the economy. This often results in fiscal deficits, as it circumstantially involves expending beyond available financial receipts. Thus, huge deficits commonly feature in economic management and administration of Nigeria. The aftermath of the fiscal deficits are high inflation and interest rates, among others. Government has various modes of financing its sustainable development programs, which include taxation, printing of more money, grants, and borrowing. The factors that occasion fiscal deficits in Nigeria have to do with the low level of economic development, slow growth in government revenue, instability of public revenue, poor control of public expenditure and increasing government participation in driving the economy. In many cases, government borrows any amount required to finance the fiscal deficits, not minding the rate of interest.

However, the way fiscal deficits are financed determines the possible effects on macroeconomic fortunes. If deficits are financed by borrowing, especially through ways and means advances, they may bear negatively on output growth. Where they are financed through taxes and printing of more money, the inflation rate may rise. Thus, there are intricacies associated with deficits and inflation. The more funds channeled to finance deficits the higher the inflation rate. Inflation may be further influenced by deficits which are accommodated by monetary policy. As the deficits cause increase in money supply, they also fuel inflation.

In some public expenditure outlay, political considerations equally outweigh economic considerations. To meet the socio-political expectations of the citizenry, public expenditure swells thereby leading to deficits. Even when genuine capital-intensive programs are budgeted for and made to match expected revenue, market distortions may necessitate significant fiscal adjustments in the affected period, resulting in sharp drop in expected revenue. In Nigeria, in the mid-1980s, there was sharp fall in oil prices. After a budget had been passed based on $22 per barrel projection, the price fell to $17 per barrel, and the logical recourse for government was to adjust through deficit financing. As the budget was approved, various ministries, departments and agencies were poised for implementation, but not long, they found themselves at crossroads of miscalculations, mal-projections, attendant distortions and floored expectations. The vicissitudes were associated with increase in prices of goods and services with over-bearing demand on the fragile financial system. Social factors also necessitate deficit financing, especially where there are national emergencies such as floods, earthquakes, famine and other natural disasters. Social commitments relating to education, health and poverty reduction are capital intensive and the desire to promote them in various communities puts pressure on government finances leading to more deficits.

Essentially, fiscal deficits, while helping to drive development of an economy, occasion some phenomenal positive experiences in the areas of employment, investment and new businesses spring ups. Thus, deficits may be targeted at increasing aggregate demand and intensifying multi-economic activities. Nonetheless, deficit

spending by government is characterized by double-plunge outcome. It is geared towards filling possible gaps between public revenue and public expenditure, and these have to do with the macroeconomic dialectics that make for sustainable fiscal efficiency (Emenalo, 2002; Jhingan, 2004). In this study, therefore, budget deficit is examined in relation to economic aggregates such as gross domestic product, inflation, interest rates, and money supply. The pertinent research question is: *To what extent is budget deficit related to gross domestic product, inflation, interest rates, and money supply?* The comprehensive research hypothesis (CRH) elicited is:

CRH_O: *Budget deficit has no significant relationship with gross domestic product, inflation, interest rates and money supply.*

2. Literature Review

Although economic policies are targeted at reducing unemployment, increasing industrial productivity, and curtailing inflation, the process usually results in budget deficits which increase public debts. With budget deficits, government adds to national debt because it borrows to finance the deficits (Udu & Agu, 2000; Lipsey & Chrystal, 2005). Deficits are generally associated with recession which has drastic effect on public revenue and expenditure. It is deliberately created to fill gaps between public financial inflows and outflows as they are applied to expenditure. The deficits bring about direct addition to gross national expenditure as government dispenses funds in excess of takings which come in the form of taxes, enterprise earnings, public loans, deposits and miscellaneous sources (Darrat, 2002). The dialectics of budget deficits theoretically border on the Ricardian, Keynesian and Neoclassical views. The Ricardian adherents relate deficit finance to tax. They base their argument on the premise that the impending burden of budget deficit is on the present and not future generation. Accordingly, where there is an increase in deficit by certain proportion, taxes are expected to increase by the same proportion. However, neither the amount of deficit nor the amount outstanding of accumulated debt appears to be the major concern in the determination of interest rate (Jhingan, 2005; Begg, Fischer & Dornbusch, 2003).

Nonetheless, government may finance any level of expenditure through taxes, by borrowing money from the public or by expanding money supply. The adverse consequences relating to budget deficit, thus, result from excessive levels of government expenditure, which directly affect economic activity and runs through several years. For the Keynesian adherents, the size of budget deficit depends on discretionary tax and expenditure decisions. In their analysis, budget deficit moderates or seeks to terminate recession especially when it is so severe. Thus, when an economy experiences high unemployment, it increases government responsibility and associated purchases. This visibly creates markets for business, expands income, and encourages greater consumption expenditure. The increased size of the markets due to government deficits stimulates the economy with anticipated higher business profitability and greater investment optimism. All these go to boost private sector commercial and industrial activities. The neoclassical adherents see structural deficit as the source of various economic ills, because it persists through various business cycle phases. The general level of government spending becomes too high for prevailing tax levels in the economy. The very critical negative aspect of budget deficits is the effect on interest rates which extends to private investments.

As government borrows from the public to finance its expenditure, the increased government demand for credit puts pressure on interest rates and further crowds out private investments which compete for the same funds. In the long run, interest rate reduces private capital stock and the high cost of borrowing goes further to slow down economic growth and undermine standard of living in the future. However, if government uses the funds so generated at the expense of private borrowing by investing them in strategic economic sectors, the outcome may reasonably reduce the burden on the future generation. By this position, public sector capital is expected to be more productive than displaced private sector capital. Deficits may also crowd out domestic exporters where government borrowing increases domestic interest rates. This makes domestic investment appear more attractive to foreign investors, thereby leading to capital flows from abroad to the domestic economy. These capital inflows also bring about increase in demand for the domestic currency (Fourie & Buger, 2000; Beniano, 2003). Consequently, the highly valued domestic currency empowers domestic consumers to buy foreign goods more but it makes it more difficult for domestic businesses to sell their products overseas.

The pressure of deficit which directly bears on the government, may in a large magnitude, compel the monetary authority to monetize the debt, thereby increasing money supply and further fueling inflation. This is common experience in Nigeria and many other developing countries, where large deficits are contracted by governments who often default on their debts. Fundamentally, deficit budgets are financed through domestic or external sources. The domestic sources include funds from the banking system as well as the non-banking public. The banking system comprises the central (apex) bank and the private banks. The private banks consist of deposit money banks (DMBs) and merchant/investment banks (MIBs). The financing of budget deficits by the banking system in Nigeria is regulated by the Central Bank of Nigeria (CBN), which remains the banker to the Nigerian government. It provides the legal framework for temporary accommodation of government finances in its

enabling law. The law empowers the CBN to grant ways and means advances to the Federal Government of Nigeria (FGN) up to 25% of estimated recurrent budget revenue. However, the statutory limit (25%) was reviewed downwards in 1991 to 12.5% of the estimated recurrent budget revenue. The ways and means being an overdraft facility is, therefore, provided by to meet the cash flow inadequacies of the federal government, to be paid back by the end of the same fiscal year.

Private banking institutions equally help to finance the activities of government through purchase of investment instruments floated in the primary and secondary markets. Domestic borrowing also comes from the non-bank constituency with the key institutions comprising insurance companies, pension and provident funds, savings and loan associations, development finance institutions (DFIs), discount houses and individual investors. The instruments may be in the form of short-term treasury bills in the money market or development stocks/bonds which are of long-term nature and are tradable in the capital market. However, the ability of government to source funds from the private sector depends on the sophistication of financial markets in the economy and the willingness of private investors to hold government bonds. These are the imperatives of government-driven infrastructure investments which have to do with the dialectics of deficits and operationally define the dynamics of economic management and administration in the Nigerian nation.

3. Research Methodology

Data for this study were sourced from the Central bank of Nigeria (CBN) and National Bureau of Statistics. Econometric methods, including vector auto-regression (VAR) and Augmented Dickey Fuller unit root test, were employed in data analysis, aided by software package for social sciences (SPSS – Version 15). The endogenous variable in the research apparatus are gross domestic product, inflation, interest rate, and money supply; while the exogenous variable is budget deficit (Mpia, 2010; Ogunbunmi, 2011). For analytical purposes, the variables are designated thus: gross domestic product as GDP, Inflation as INF, Interest rate as INT, money supply as MS, and budget deficit as BD. The facilitating Multiple Regression Model is:

$BD = f(GDP, INF, INT, MS)$

$BD = a + \beta_1 GDP + \beta_2 INF + \beta_3 INT + \beta_4 MS + u$

A priori economic expectation is $\beta > 0$

Where: a = Intercept; β_1 to β_4 = Regression coefficients; and u = Stochastic error term.

The relevant time series provided are for 23 years, covering the period 1980 to 2006 as presented in Tables 1 and 2:

Table 1: Fiscal Operations of the Federal Government (₦ Billion)

Year	Revenue	Expenditure	Surplus/Deficit	% of GDP
1980	12.99	14.97	-1.98	3.9
1981	7.51	11.41	-3.9	-7.7
1982	5.82	11.92	-6.1	-11.8
1983	6.27	9.64	-3.36	-5.9
1984	7.27	9.93	-2.66	-4.2
1985	10.0	13.04	-3.04	-4.2
1986	7.97	16.22	-8.25	-11.3
1987	16.13	22.02	-5.89	-5.4
1988	15.59	27.75	-12.16	-8.4
1989	25.89	41.03	-15.13	-6.7
1990	38.15	60.27	-22.11	-8.5
1991	30.83	66.58	-35.76	-11.0
1992	53.26	92.8	-39.53	-7.2
1993	83.49	191.22	-107.74	-15.5
1994	90.62	160.89	70.27	-7.7
1995	249.77	248.77	1.0	0.1
1996	369.27	337.22	32.05	1.6
1997	423.22	428.22	-5.0	-0.2
1998	353.72	487.11	-133.39	-4.7
1999	662.59	947.69	-285.1	-8.4
2000	0.6	0.7	-103.8	-2.9
2001	0.8	1.02	-221.0	4.7
2002	0.72	1.02	-301.4	5.6
2003	1.02	1.23	-202.7	2.9
2004	1.25	1.43	172.6	1.7
2005	1.66	1.82	-161.4	-1.5
2006	1.84	1.94	-101.3	-0.6

Source: CBN and NBS Publications (various years)

Table 2: Nigeria's GDP at Constant Basic Prices (₦ Billion)

Year	GDP	Growth Rate (%)	% Δ in GDP
1980	-	-	-
1981	251.05	-26.8	26.8
1982	246.73	-1.7	25.1
1983	230.38	-6.6	4.9
1984	227.25	-1.3	5.3
1985	253.01	11.3	12.6
1986	257.78	1.8	-9.5
1987	25.6	-0.7	2.5
1988	275.41	7.5	-8.2
1989	295.09	7.1	-0.4
1990	472.65	60.1	53.0
1991	328.64	-30.5	90.6
1992	337.29	2.6	33.1
1993	342.54	2.7	0.1
1994	345.29	1.3	-1.4
1995	352.65	2.2	0.9
1996	367.22	3.4	1.2
1997	377.83	3.8	0.4
1998	388.47	2.4	-1.4
1999	393.11	2.8	0.4
2000	412.33	3.3	0.5
2001	413.78	5.0	1.7
2002	451.79	4.6	-0.4
2003	495.01	9.6	5.0
2004	527.58	6.6	-3.0
2005	561.93	6.2	0.4
2006	594.82	8.9	2.7

Source: CBN and NBS Publications (various years)

4. Findings & Discussion

The details of comprehensive research hypothesis (CRH) test are presented in Tables 3, 4 and 5:

Table 3: CRH Associating Coefficients (R)

Variables	BD	GDP	INF	INT	MS
BD	1	-0.13	0.26	-0.37	0.14
GDP	-0.13	1	-0.23	0.50	0.88
INF	0.26	-0.23	1	0.09	-0.26
INT	-0.37	0.50	0.87	1	0.17
MS	0.14	0.88	-0.26	0.17	1

Source: Research Data (SPSS-aided)

Table 4: ADF Unit Root Test Results

	Statistic	Prob. Value	Critical Values	Critical Values	Critical Values	Lag Length
Variable			10%	5%	1%	
GDP	-0.08	0.94	-3.72	-3.00	-2.63	1
INF	-2.62	0.10	3.71	-2.98	-2.63	0
INT	-2.73	0.08	-3.71	-2.98	-2.63	0
MS	-4.26	0.00	-3.79	-3.01	-2.65	5

Source: Research Data (SPSS-aided)

Table 5: CRH Determining Coefficients (R^2)

Variables		GDP	INF	INT	MS
With BD		0.85	0.183	0.021	0.966

Source: Research Data (SPSS-aided)

In the Table 3, the results indicate the correlation coefficients relating budget deficit to gross domestic product, inflation, interest rate and money supply as -0.13, 0.26, -0.37 and 0.14 respectively. This shows that budget

deficit significantly relates positively with inflation and money supply; but negatively with gross domestic product and interest rate. The Augmented Dickey Fuller (ADF) unit root test details are presented in Table 4. Essentially, the statistics and their corresponding probability values affirm overall regression model suitability. The variations in budget deficits are explained by the dynamics of the determinants, especially gross domestic product and money supply which recorded coefficient of determination of 0.825 and 0.966, representing 82.5% and 96.6% potency respectively. The economic *a priori* expectation, the null comprehensive research hypothesis is, therefore, rejected. This establishes that budget deficit significantly relates to gross domestic product, inflation, interest rate and money supply.

The deficits arise as a result of government overbearing public infrastructure investment commitment. The infrastructure, being development-oriented, relates to roads, water, power, telecommunication, education, and health care facilities (Central Bank of Nigeria, 2000). With the perpetual feature of deficits in fiscal management, the dialectics have to do with gross domestic product (GDP), inflation, interest rate and money supply. GDP remains a primary measure of an economy's performance, denominated in annual total output of goods and services. It represents the total market value of all final goods and services produced in a given year. The determination of GDP in the short-run depends on the behavior of aggregate spending, consumption, government expenditure and net exports (Lipsey & Chrystal, 2005; Marques, 2004)). With GDP, a monetary measure is accorded the goods produced within an economy to facilitate meaningful comparative analysis over a time frame. In the light of this, it assumes a measure of value-added to materials and other inputs in the production of goods and services by residents and organizations before allowing for depreciation or capital consumption.

To measure aggregate output more precisely, all goods and services produced in a particular year has to be counted once, and this captures only the market value of final goods. It excludes intermediate goods since the value of final goods already represents them. Interest rate represents the price paid to borrow and use funds. It is the cost of holding money, and the price paid to make people willing to forgo the economies of liquidity. Consequently, interest rate helps in the mobilization of savings and ensures efficient fiscal allocation in the promotion of economic growth and development. Interest rate is also used to weigh the activities of the financial market. It determines supply and demand of loans which invariably affect cost and value of production. Since economic activity is influenced to a large extent by interest rate, when deficits are financed by borrowing, interest rates soar. Interest rates also define the direction and magnitude of changes in the market for money supply, hence the primary concern to economic actors and policy makers. However, several factors influence the behavior of interest rate in an economy, namely, anticipated inflation and government spending. Government policy regarding borrowing requirements has direct consequence on the growth of credit. As government borrowing puts pressure on the demand for credit, interest rates rise, implying increase in the cost of borrowing.

By this, government activity further influences interest rates which in turn increase deficits. As government borrowing increases deficits, it further raises interest rates which in turn determine the level of government borrowing. These are the realities of the macroeconomic dialectics, as expansion of government credit leads to expansion in aggregate credit. The pressure on government borrowing requirement to meet the provision of goods and services raises interest rates which imply increase in cost of borrowing. As the financial outlay required for the provision of social goods and services increases, it pressures government into excessive borrowing and as borrowing puts pressure on demand for credit, cost of borrowing (interest rate) equally increases. Also, with respect to bonds, the high risk of default is compensated through higher interest payment to bond holders (Olayide, 2010; Gbosi, 2005; Onoh, 2002). Financing deficits by borrowing, thus, has to do with interest rates, but where the financing is through taxes and printing of more money, it may not have much to do with interest rates. Money supply is also a critical macroeconomic variable for consideration in mainstream deficit dialectics. It relates to the amount of money in circulation, particularly for economic utilization. Since the stock of money refers to the quantity available in an economy at a point in time, the apex bank constitutes the major determinant of money stock.

The realities of the economy determine the level of money supply to be expected and the nature of adjustments to be made from time to time. If funds are generated from the banking system to bridge deficits, especially from the apex bank, it would have expansion effect on money supply. The financing of such deficits results in sustained injection of huge amounts of money into the economy which accelerate the growth of money supply. The financing of government deficits may, therefore, contribute to rapid growth of money supply if well strategically directed. The effectiveness of regulation of money supply in Nigeria had also been mirrored in the efficiency government spending and fiscal management (Onoh, 2007; Ilo, 2006; Adam & Bankole, 2000). In essence, deficits resulting from increase in government participation in the provision of development-oriented goods and services in Nigeria cause increase in money supply. The huge deficits are usually financed through ways and means advances from the Central Bank of Nigeria (Adeoye, 2006; Adewuyi, 2000). Growth in government sector credit then drives growth in aggregate credit, thus making money supply a major component

of macroeconomic dialectics, which clearly reveal the tango of budget deficits and the analytical correlates in the study.

5. Conclusion

For so many years, fiscal deficits have become a regular feature of macroeconomic policy in Nigeria over the years. This tendency also occupies centre stage in economic management deliberations in many other economies. Ideally, government fiscal operations are strategically designed and directed at stimulating economic growth. When critical infrastructure is provided and meaningful projects are undertaken, they should ultimately contribute to economic growth and development. However, in the Nigerian situation, the generation and application of deficits still leave so much to be desired in terms of the manifest characteristic developmental outcomes. Government sometimes cuts investment spending only to undermine its capacity to provide and maintain the needed infrastructure for the much-desired economic growth and development (Gbosi, 2005; Engen & Hubband, 2004). Where deficits do not analytically relate to gross domestic product, governance may not have exerted significant influence on overall output and investment in the economy. Essentially, this refers to the situation where the government funds, which actually occasioned the deficits, were rather largely wasteful (Gbegi & Orugun, 2009; Adeoye, 2006).

In other instances, government expenditure occasions deficits for the basic reasons for which intervention is neo-classically canvassed in an economy. This position recognizes the many situations where the market mechanism has failed to produce desirable results; and where many goods which are universally desired are not produced through free operations of the market. These circumstances compel government to directly engage in the provision and distribution of such goods and services. The ensuing financing and allied challenges make it imperative for government to directly assume that role of undertaking infrastructure investment in order to promote economic growth and development. Considering the huge financial outlay that is required for well-spread infrastructure investments, the private sector which should strategically partner and complement becomes so reluctant to invest. Moreover, such critical socio-economic areas and focal sectors are perceived as high-risk and low-return investment outlets. Government, thus, becomes the last resort, as it must take the responsibility of creating the needed infrastructure for economic growth and development. For oil-rich economies like Nigeria, the state is presumed to have abundant financial resources and as such is expected to be in a better position to fund and provide those industrial infrastructure and allied economic goods and services with long gestation periods. As government expenditure comes to complement private investment, it leaves fiscal deficits in its trail. With fiscal deficits, government continuous investment in critical economic and social services should constructively influence the activities of the private sector. By this, the macroeconomic dialectics significantly intensify growth or expansion of economy (Nsudoh, 2011; Jhingan, 2004).

As growth of public expenditure boosts economic activities, it directly enhances the income of private sector entities and consequently, the demand for goods and services. It equally leads to increase in price level as aggregate demand exceeds aggregate supply. Where government finances deficits through borrowing, rising interest rates influence production activities. Furthermore, the fiscal operations of the government have crucial implications for money supply in the economy; and changes in gross domestic product are expected to redefine transaction balances with fresh injection of money into the economy. This also comes along with budget deficits, as it further enlarges the currency in circulation. All these go to dictate the magnitude and pace of money supply, interest rates, inflation and GDP, especially in settings like the Nigerian economy where the private sector is not so developed. Given that open market operation (OMO) in the economy is still undermined by grays of inefficiency and ineffectiveness, deficit financing is expected to be strategically managed and controlled by the Central Bank of Nigeria (Garuba, 2010; Onoh, 2007; Laubach, 2003). These scholarly submissions are in tandem with the analytical outcome that deficits are associated with gross domestic product, inflation, interest rates and money supply which constitute the key economic aggregates of this study. Where the deficits are truly intended to financially power the government to achieve the underscored strategic economic growth and development objectives, it is recommended that:

- Infrastructure and socio-economic projects associated with deficits should be well prioritized and realized to improve the quality of life in the economy;
- Macroeconomic correlates of deficits should be closely monitored and expediently redirected to boost productive activities in the economy; and
- Administrative mechanisms should be strengthened to enhance management of government expenditure, with special reference to strategic sectors of the economy.

With the appropriate checks and balances in place, it is expected that various organs of government will thoroughly prevent wasteful spending and misapplication of deficits to record meaningful justifiable progress with the resources of the economy.

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