

An Analysis of Budget Deficit and Inflation on Economic Development in Nigeria

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Abstract: Budget deficit and inflation are important macroeconomic variables that influence the development of an economy which has its resulting effect through increase in government expenditure. This study examined the effect of budget deficit and inflation on economic development in Nigeria from 1981 to 2018. The study made use of secondary data sourced from the Central Bank of Nigeria Statistical Bulletin (2018). A test for unit root and co-integration using the Augmented-Dickey Fuller (ADF) and Bound Test were conducted among the variables namely budget deficit, inflation, money supply, total government debt and per capita income. The Pairwise Granger Causality test was carried out to determine the direction of causality among the variables. Autoregressive Distributed Lag technique was employed to examine the relationships among the variables used. The result of the ARDL coefficient indicated that budget deficit as a percentage of gross domestic products and inflation rate had negative and significant effect on per capital income both in the short and long run. However, the Bound Co-integration test revealed that there is long run equilibrium relationship among the variables. The Pairwise Granger Causality test result showed that budget deficit did not granger cause economic development while inflation granger cause economic development. The conclusion from the findings of the study showed that as budget deficit widens, economic development (proxy as per capita income) reduces and the different sources of financing the deficit are inflationary induced. The study recommended that, government should watch the growth rate of money supply as source of financing deficit due to the negative effect of inflation on economic development; efficient strategies should be device to ensure effective management of resources through elimination of inefficiency and curbing of corruption in government institutions.

Keywords: Budget Deficit, Inflation, Per Capita Income, ARDL Model

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I. Introduction

Modern governments are faced with diverse responsibilities and challenges which must be solved in order to achieve growth and development. However, government incurred huge cost as a result of meeting its responsibilities which sometimes are larger than generated revenue which lead to budget deficit.

Budget deficit is a situation whereby government expenditure exceeds revenue. Akinmulegun (2014) defined budget deficit as increase in government expenditure over her revenue which may result from shortage in government revenue or responsibilities. Nayab (2015) also defined deficit financing as the government policy of creating fund to finance deficit by borrowing whether from local or foreign sources which must be repaid with interest within a specific period of time. Adesuyi and Falowo (2013) stated that fiscal deficit has become a recurring feature in both developed and developing countries which arises due to inadequacy in tax collection and increased government expenditure on infrastructure. Budget deficit is necessary in most developing countries that are facing high economic challenges with low revenue to cater for huge government expenditure.

According to Fatima, Ahmed and Rehman (2012), budget deficit serves as a blue print and development tool used by government to enhance sustainable growth and development through increase in spending of government. Budget deficit can be felt through policies that promote provision of social amenities and infrastructural development by the public sector which stimulates private sector investment in the economy. Adesuyi and Falowo (2013) stated that budget deficit involves the printing of money or obtaining of funds to finance the gap in the annual budget of the economy.

The implication of deficit financing on the economy has been the major focus of government and policy maker in developing countries like Nigeria. Chaudhary and Abe (1999) opined that deficit financing may result in high inflation, low growth, current account deficit and private investment and consumption crowds out. In the monetarist framework, deficits tend to be inflationary because when monetization takes place, it will lead to an increase in money supply and, ceteris paribus, increase in the rate of inflation in the long run (Gupta, 1991). Thus, persistent fiscal deficit can hamper growth and development of an economy. Boariu and Bilan

(2007) stated that while budget deficit plays significant role in promoting economic growth, financing of deficit in the budget may results in inflationary pressure which may negate the growth objective of fiscal deficit.

In Nigeria, price stability is one of the foremost objectives of monetary policy. This is because no economy can achieve growth without price stability. However, the objective of price stability is in the light of rising deficit which requires additional funds for financing it. In 1986, the government introduced Structural Adjustment Programme with the hope that with restructuring of the economy, there would be reduction in the deficit spending. The Central Bank of Nigeria Statistical Bulletin (2017) indicated that budget deficit rose from ₦47.38 billion in 2008 to ₦810.01, ₦1105.40 ₦1158.52 billion in 2009, 2010 and 2011 respectively (CBN, 2017). Furthermore, deficit in the budget stood at ₦975.78 in 2012, it rose to ₦1,153.49 in 2013 before falling to ₦835.68 billion in 2014. Nigeria has continued to experience budget deficit since 2015 with deficit figure of ₦1557.79 billion, ₦2208.22 billion in 2016 and ₦3679.50 billion in 2017 (CBN, 2017). The increased in fiscal deficit which must be financed from different sources must be done in the light of price stability.

However, as a result of the rising budget deficit and financing of the deficit which may negatively influence the price stability objective of Nigeria, the government has been trying to reduce budget deficit in Nigeria. Despite these efforts, budget deficit has been increasing with little effect on the economy. The nation is experiencing high level of unemployment, insecurity and poverty and falling standard of living (Solawon & Adekunle, 2018). The rising of deficits in Nigeria led to heavy debt burden, poor economic performance and fall in social welfare (Ojong, Owui & Effiong, 2013).

The effect of deficit financing on economic growth is an interesting and trending issue which has received the attention of scholars. However, majority of the reviewed studies in Nigeria and other countries only examine the effect of deficit financing on economic growth (Adesuyi & Falowo, 2013; Ahmad, 2013; Akinmulegun, 2014; Edame & Okoi, 2015; Nayab, 2015; Solawon & Adekunle, 2018).

The reviewed studies did not examine the effect of deficit financing on economic development (Ahmad, 2013; Akinmulegun, 2014; Edame&Okoi, 2015; Nayab, 2015; Solawon & Adekunle, 2018). While studies used gross domestic product as a measure of economic growth (Ahmad, 2013; Akinmulegun, 2014; Edame & Okoi, 2015; Nayab, 2015; Solawon & Adekunle, 2018), this study employed per capita income which is more encompassing and revealed the true state of the economy in terms of citizens' living standard according to Todaro and Smith (2002). Also, very few studies in Nigeria examine the joint effect of budget deficit and inflation on economic development. Finally, the direction of causality among budget deficit, inflation and economic development was not established in reviewed literature. Thus, this study filled the above gap by examining the effect of budget deficit and inflation rate on economic development in Nigeria.

II. Empirical Review

Taylor, Proano, Carvalho and Barbosa (2012) explored the impact of the 'primary' fiscal deficit on economic growth and debt using VAR from 1961 to 2011. It was reported that higher spending and lower taxes have a positive impact on output expansion. Onuorah and Ogbonna (2013) analyzed the effect of deficit financing on the Nigerian economy using data from publications of the Central Bank of Nigeria Statistical Bulletin between 1981 and 2012 which was analyzed with OLS. The study revealed that domestic debt and external debt liability had positive effect on economic growth in Nigeria.

Fatima, *et al.*, (2012) looked at the impact of the budget deficit on the economic growth using time-series data from 1978 to 2009. The result of the OLS revealed that budget deficit had negative effect on the economic growth of Pakistan. Ahmad (2013) investigated the relationship between budget deficit and gross domestic product of Pakistan from 1971-2007 which was analyzed with OLS. The result showed that foreign direct investment and budget deficit had positive effect on economic growth of Pakistan.

Akinmulegun (2014) employed Vector Auto Regression (VAR) Model to examine the relationship between deficit financing and economic growth in Nigeria. The relevant variables used are as follows: real gross domestic product (RGDP), the gross capital formation (GCF), the real interest rate (RINTR), inflation rate (INFR) and budget deficit. It was discovered that deficit financing has not contributed significantly to economic growth in Nigeria which because of the negative impact of deficit financing on economic growth during the period under review. Adesuyi and Falowo (2014) examined the relationship between fiscal deficit and the Nigerian economy; the overall objective being to assess and investigate the impact fiscal deficit has on the economy given some variables. The result showed that fiscal deficit has made a significant contribution to GDP and economic growth of the country Nigeria.

Nayab (2015) assessed the impact of budget deficit on economic growth in Pakistan during the period 1976 to 2007. The vector error correction model was used for analysis purpose. The result showed that budget deficit had insignificant effect on economic growth. Bhoir and Dayre (2015) examined the impact of fiscal deficit on economic growth for the Indian economy for the period 1991 and 2014. The result of the ordinary least squares method showed insignificant relationship between the two variables.

Edame and Okoi (2015) examined the impact of fiscal deficit, interest rate and gross fixed capital formation on economic growth in Nigeria during the period 1985–1998 and 1999–2013 using the ADF and the Chow endogenous break tests to examine the growth impact of fiscal deficits before and after the advent of democracy in Nigeria in 1999. It was found that fiscal deficit had a significant impact on economic growth during the military regime only had a significant growth impact during both regimes. Eze and Festus (2016) adopted ECM to investigate the relationship between deficit financing and economic growth in Nigeria from 1970 to 2013 it was found that there is significant relationship between deficit financing and economic growth in Nigeria.

Navaratnam and Mayandy (2016) examined the impact of fiscal deficit on economic growth in some selected South Asian countries, namely, Bangladesh, India, Nepal, Pakistan and Sri Lanka, using time series annual data over the period of 1980 to 2014 using co-integration and granger causality test. The results showed that fiscal deficit had negative impact on economic growth in the South Asian countries considered in this study except Nepal, which was positive. Nwaeke and Korgbeelo (2016) assessed the relationship between deficit financing and selected macroeconomic variables in Nigeria using annual time-series data on these variables from 1981 to 2013 analyzed with the aid of ordinary least squares (OLS). The study found that deficits financed from external loans had insignificant and negative influence on economic growth while deficits financed from domestic sources stimulated economic growth in Nigeria.

Duokit and Ekong (2016) examined the relationship between budget deficit and economic growth in Sierra Leone using Ordinary Least Square (OLS) estimation technique. The analysis showed positive relationship between budget deficit and economic growth in Sierra Leone. Saima and Uddin (2017) analyzed the relationship between budget deficit and public debt in Bangladesh over the period 1995 to 2015. The study employed Augmented Dickey-Fuller (ADF) and Phillips- Perron (PP) tests, Johansen Co-integration techniques and Vector Error Correction Model (VECM) techniques for analysis. The result of the co-integration test showed the presence of long run equilibrium relationships between the two variables. The Vector Error Correction Model (VECM) showed negative relationship between budget deficit and public debt.

Okafor, Maduka, Ike and Uzoechina (2017) focused on the effect of tax-financing of budget deficit under Laffer curve theory from 1970 to 2015 analyzed using ADF, CUSUM, Heteroskedasticity, multiple regression, Johansen co-integration and ECM. The result indicated that custom and exercise duties, petroleum profit tax and value-added tax had significant effect on budget deficit while company income tax had no significant impact on budget deficit. Nwanna and Nkiruka (2019) examined the effect of deficit finance on Nigeria economic growth from 1981 to 2016 using Augmented Dickey Fuller (ADF) unit root test, Johansen Co-integration test and ECM. It was found that deficit financing through external debt borrowing had significant and negative effect on Nigeria's economic growth while domestic debt had positive and significant effect on Nigeria's economic growth.

III. Methodology

Quantitative research design was adopted to examine the effect of deficit financing and inflation on economic development. The data for this study consisted of time series data covering the period of 1981 and 2018. Data such as budget deficit, money supply and government total debt and per capita income were obtained from Central Bank of Nigeria Statistical Bulletin (2018).

3.1 Model Specification

This study is based on Keynesian twin deficit theory developed by British Economist John Maynard. Keynesian theory indicates that, in developing and underdeveloped economy, increase in government deficit raises disposable income which stimulates aggregate demand and development. This study adapted the empirical model of Ahmad (2013) which is given as:

$$GDP = f(BD, FDI).$$

Where,

GPD = Gross Domestic Product

BD = Budget Deficit

FDI = Foreign Direct Investment.

The model for this study is modified by using per capita income as a proxy for economic development and broad money supply is also incorporated in the model. The model is specified as:

$$LPCI = f(BDGDP, INFR, LMS, LGTD)$$

The linear function of the above model is given as

$$LPCI = \beta_0 + \beta_1LBD + \beta_2INFR + \beta_3LBMS + \beta_4LGTD + \mu$$

Where

LPCI = Log of Per Capita Income

LBD = Log of Budget Deficit

INF = Inflation Rate
 LBMS = Log of Broad Money Supply
 LGTD = Log of Government Total Debt
 β_0 = Constant Term
 $\beta_1 - \beta_4$ = Parameters of the estimated variables
 μ = Error Tem

3.2 Data Estimation Techniques

Multiple regression technique was adopted to examine the effect of deficit financing and inflation on economic development in Nigeria. The techniques employed are Augmented Dickey-Fuller Unit Root Test, Bound Co-integration Test and Granger Causality test.

Augmented Dickey-Fuller unit root test technique was employed to test the stationarity of the time series data in order to avoid spurious regression which usually affects the reliability of time series data. Also, Bound Co-integration technique is adopted to ascertain the long-run association-ship among the variables capture in the model.

Autoregressive Distributed Lag model technique was used to examine the effect of budget deficit, money supply, government total debt and inflation rate on per capita income both in the short and long run and also to estimate the speed of adjustment in the model. However, in order to ascertain the direction of causality among budget deficit, money supply, government total debt, inflation rate and per capita income, Pairwise Granger Causality technique was adapted. Finally, Jargue-Bera Statistic normality test, Breusch-Godfrey Serial Correlation LM Test and Breusch-Pagan-Godfrey Heteroskedasticity were employed to test to check the reliability and robustness of the model.

IV. Results and Findings

4.1 Correlation Matrix

Table 1 Correlation Matrix

	LPCI	BDGDP	INF	LBMS	LGTD
LPCI	1.000000				
BDGDP	-0.098844	1.000000			
INF	-0.301280	0.099462	1.000000		
LBMS	-0.081169	-0.308902	0.469857	1.000000	
LGTD	-0.355406	0.277984	0.053183	-0.167389	1.000000

Source: Researchers' Computation, 2020

The Pearson correlation test is presented in Table 1 and it shows the absence of multi-co linearity among the variables since the correlation values are less than 0.7. Furthermore, the result shows the explanatory variables namely budget deficit as a percentage of gross domestic product, inflation rate, log of broad money supply and log of government total debt have negative correlation with log of per capita income.

4.2 Stationarity Test Result

Table 2 Augmented-Dickey Fuller Test Unit Root Test

Series	t-Statistic	5% Critical Value (Pro)	Level of Integration
LPCI	-3.180464	-2.945842 (0.0295)	1(1)
BDGDP	-4.599615	-2.945842 (0.0007)	1(0)
INF	-5.434168	-2.954021 (0.0001)	1(1)
LBMS	-3.662891	-2.945842 (0.0091)	1(1)
LGTD	-4.373627	-2.945842 (0.0014)	1(1)

Source: Researchers' Computation, 2020

The result of the Augmented Dickey-Fuller Unit root test is reported in table 2. The result indicates that budget deficit as a percentage of gross domestic product is stationary at level while inflation rate, log of per capita income, log of broad money supply and log of government total debt are not stationary at level.

Thus, log of per capita income, log of broad money supply, log of government total debt and inflation rate are subject to unit root test at first difference and it turn out that log of per capita income, log of broad money supply, log of government total debt and inflation rate are stationary at first difference as reported in table 2.

4.3 Lag Selection Result

Table 3 Lag Selection Criteria

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-363.7282	NA	542.1730	20.48490	20.70483	20.56166
1	-150.7039	355.0404*	0.016009*	10.03911*	11.35871*	10.49968*
2	-125.9141	34.43028	0.017636	10.05079	12.47005	10.89517

Source: Researcher's Computation, 2020

The result of the lag selection criterion is depicted in table 3. It indicates that the optimum lag for the estimation of ARDL is lag 1 as revealed by Akaike Information, Schwarz information criterion and Hannan-Quinn information criterion.

4.5 Residual Diagnostic Test

Table 4 Diagnostics Results

Diagnostics test	Observed value	P-value (Chi-square)
Normality Test (Jarque-Bera)	0.37794	0.8278
Breusch-Godfrey LM test for serial correlation	6.329560	0.0966
Heteroskedasticity Test: Breusch-Pagan-Godfrey	14.59815	0.0674

Source: Researchers' Computation, 2020

Table 4 reports the diagnostics test for the regression result. The Jarque-Bera normality test shows the regression residual normally distributed because the Jarque Bera probability value of 0.8278 is greater than 0.05 acceptance region. Also, the Breusch-Godfrey LM serial correlation test shows that there is no serial correlation in the regression's residual as indicated by the Breusch-Godfrey Chi-square value of 0.0966 which is greater than 0.05. Finally, the result of Breusch-Pagan-Godfrey Heteroskedasticity Test shows a probability value of 0.0674 which is statistically insignificant at 5% critical value thus leading to the acceptance of null hypotheses that the residual is Homoscedatic. Thus, having tested the residual of the regression and found that the model is satisfactory, the long run relationship using Bound Co-integration test is interpreted in Table 4.

4.5 Co-integration Test Result

Table 5 Bound Co-integration Test

Test Statistic	Value	K
F-statistic	14.87027	4
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	3.03	4.06
5%	3.47	4.57

Source: Researcher's Computation, 2020

The long run relationship among the variables is determine using Bound Co-integration technique and reported in Table 5. The result shows that the Bound F-statistic is given as 14.87027 while the upper bound critical value at 5% significant level is given as 3.47. This implies that the Bound F-statistic value is greater than upper bound critical value at 5% leading to the conclusion that there is long run relationship among budget deficit as a percentage of gross domestic product, log of broad money supply, log of domestic debt, log of external debt, inflation rate and log of per capita income.

4.6 Autoregressive Distributed Lag Model Result

Table 6 Short Run Co-integrating Result

Cointegrating Form				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(BDGDPI)	-0.002150	0.000473	-4.550111	0.0001**
D(INF)	-0.000456	0.001033	-0.441492	0.6622
D(LBMS)	0.304920	0.053868	5.660495	0.0000**
D(LGTD)	0.213619	0.038031	2.195159	0.0249**
CointEq(-1)	-0.313766	0.062287	-5.037421	0.0000**

Note: ** indicates the variable is significant at 5%

Source: Researcher's Computation, 2020

Table 6 report the result of the short run effect of budget deficit as a percentage of gross domestic product, log of broad money supply, log of domestic debt, log of external debt, inflation rate on log of per capita income. The result shows that budget deficit as a percentage of gross domestic product has negative and significant effect on log of per capita income which implies that increased budget deficit will lead to fall in per capita income in Nigeria.

The result also shows that inflation rate has negative and insignificant effect on log of per capita income which indicates that increase in inflation rate will lead to per capita income in Nigeria. Also, the result shows that log of broad money supply has positive and significant effect on log of per capita income. This implies that increase in broad money supply will lead to increase in per capita income in Nigeria.

Similarly, the study shows that log of total government debt has positive and significant effect on log of per capita income such that increase in government total debt will lead to increase in per capita income in the short run. Finally, result shows that the co-integration equation conform to the a priori expectation of -0.313766 which is significant at 5%. This implies that the short run result has a self adjustment mechanisms and any disequilibrium will be corrected at a speed of 31%.

4.7 Long Run Coefficient

Table 7 Long Run Coefficients

Long Run Coefficients				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
BDGDP	-0.006853	0.001962	-3.493879	0.0016**
INF	-0.116422	0.003517	-2.826111	0.0085**
LBMS	0.971806	0.085345	11.386851	0.0000**
LGTD	0.306091	0.052415	5.839772	0.0000**
C	-3.716986	0.332118	-11.191751	0.0000**

Note: ** indicates the variable is significant at 5%

Source: Researcher's Computation, 2020

The result of the long run coefficient presented in Table 7. The result indicates that budget deficit as a percentage of gross domestic product has negative and significant effect on log of per capita income with a coefficient of -0.006853 such that 1% increase in budget deficit will lead to 0.6% fall in per capita income. This implies that widening in government budget would lead to fall in economic development which brings about the need to finance budget deficit. Furthermore, the result indicates that inflation rate has negative and significant effect on log of per capita income with a coefficient of 0.116422 which implies that 1% increase in inflation rate will lead to 11% increase in fall in per capita income.

However, the result of the long run coefficient of ARDL reveals that log of broad money supply has a coefficient of 0.971806 which is significant at 5%. This implies that, 1% increase in broad money supply will lead to 97% increase in per capita income. Finally, it's revealed in the result of long run coefficient reported in Table 7 that log of government total debt has positive and significant effect on log of per capita income which indicates that 1% rise in government total debt will lead to 31% increase in per capital income.

4.8 Pairwise Granger Causality Test

Table 8 Pairwise Granger Causality Test Result

Null Hypothesis:	Obs	F-Statistic	Prob.
BDGDP does not Granger Cause LPCI	36	0.02959	0.9709
LPCI does not Granger Cause BDGDP		0.59638	0.5570
INF does not Granger Cause LPCI	36	4.69218	0.0166
LPCI does not Granger Cause INF		2.78888	0.0770

Source: Researcher's Computation, 2020

The result of the Pairwise granger causality result is indicated in table 8. The result shows that there is an independent relationship between budget deficit as per capita income and log of per capita income with probability value of 0.9709 and 0.5570 which is insignificant at 5%. Also, the result shows that inflation rate

granger cause log of per capita income with probability of 0.0166 while log of per capita income does not granger cause inflation rate as indicated by the probability value of 0.0770 which is insignificant at 5%.

4.9 Discussion and Implication of Findings

Budget deficit and inflation are important macroeconomic variables that influence the development process of an economy. While budget deficit arises due to excess of government expenditure, inflation may occur due to different sources of financing government deficit. However, result from this study shows that budget deficit had negative and significant effect on per capita income. The implication of this finding is that, as budget deficit widens, economic development which is measured by per capita income will reduce due to inability of government to provide basic needs to enhance per capita income due to shortage of revenue. This finding does not conform with the finding of Ahmad (2013); Adesuyi and Falowo (2013) who found positive relationship between budget deficit and economic growth but agrees with the finding of Nayab (2015) who established negative relationship between budget deficit and economic growth.

Furthermore, findings from the study showed that inflation rate had negative and significant effect on per capita income. This implies that increase budget deficit which must be finance from different sources like printing of money and government total debt may result in inflationary pressure thereby deteriorating per capita income due to loss in value of income of the citizens. The result is in line with the empirical finding of Fatima, *et al.*, (2012) that inflation rate has negative and significant effect on economic growth. Furthermore, it was found that money supply as important source of financing government deficit produced positive and significant effect on per capita income in Nigeria. The implication of this study is that increase in money supply through the adoption of expansionary monetary policy would provide means of supporting government deficit thereby enhancing per capita income. This result is in line with analysis of Eze and Festus (2015) that money supply as a source of financing deficits produced positive effect on economic growth.

Finally, the result revealed that government total debt had positive and significant effect on per capita income indicating that government debt as germane tool of supporting budget deficit will lead to increase per capita income which conforms with the result of Onuorah, *et al.*, (2013); Adesuyi and Falowo (2013) that government debt as source of financing budget deficits positively enhanced economic growth.

V. Conclusion

Budget deficit arises when government spend more than expected revenue. Budget deficit usually lead to creation of gap in government budget which must be financed through either creation of money or debt. However, the effect of budget deficit and inflation is investigated in this study from 1981 to 2018. The study established that both budget deficit and inflation rate had negative effect on economic development in Nigeria. In line with findings, it was concluded that budget deficit is inflationary in Nigeria resulting from the different sources of financing the deficit which are inflationary induced. It was thus recommended that government reduce her budget deficit; whilst, government should increase her revenue base through diversification.

Finally, there is need for government to device strategies to ensure effective management of government resources. Government should cut all sources of inefficiency and also more policies should be formulated to eradicate corruption in government parastatals.

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