

Research Article

Fiscal Deficit and Its Impact on Nigeria's Economy

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Abstract

The idea that deficit spending can help promote advanced growth, enable higher tax revenues to be generated and thus reduce the fiscal deficit over time has been area of interest. This research provides an empirical analysis of how fiscal deficits influence economic expansion within the Nigerian context. Utilizing an ex-post facto research framework, the study examines secondary data spanning the years 1990 to 2024, gotten from Central Bank of Nigeria Statistical Bulletin. To investigate the relationship between fiscal deficit indicators and national economic performance, the Fully Modified Ordinary Least Squares (FMOLS) estimation technique was employed. The analytical results indicate that the Government Budget Deficit (GBD) has a statistically significant and positive influence on Nigeria's economic output, based on probability results at a 5% significance level. Conversely, the findings suggest that Public Debt (PUD) does not exert a significant impact on the country's economic performance, with probability outcomes falling outside the 5% significance threshold. Based on these results, the paper recommends that the Federal Government implement strategic measures to refine budget deficit policies, ensuring more effective execution and resource utilization. Furthermore, it is advised that the government establish robust monitoring mechanisms to ensure public borrowing is strictly channelled toward productive economic activities. Such a shift would help protect and stimulate both private investment and the broader real sector of the Nigerian economy.

Keywords

Public Debt, Economic Growth, Budget Deficit

1. Introduction

The relationship between fiscal deficits and economic progress remains a central point of contention in global economics. John Maynard Keynes was a pioneer in this field, identifying the fiscal deficit as a strategic tool for stimulating growth in his landmark work, *The General Theory of Employment, Interest and Money* (1936). Keynes argued that during economic downturns, a rise in private sector savings coupled with reduced spending leads to underutilized resources; in these scenarios, a fiscal deficit can serve as a necessary corrective measure.

Furthermore, strategic deficit spending can catalyze advanced development, which eventually expands the tax base and allows for a natural reduction of the deficit over time [19]. When examining the specific influence of fiscal deficits on growth, existing literature offers a mix of positive, negative, and neutral conclusions. As noted by Abdullah, *et.al.*, these discrepancies are often due to the unique developmental stage of a country and its specific strategies for financing the deficit. This debate is particularly vital for emerging economies, where aggressive growth targets are core pillars of national development policy [1].

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The prevailing scholarly discourse on Sub-Saharan Africa's economic challenges frequently links the region's fiscal conditions—notably deficit financing and the management of public debt—to its developmental outcomes [5]. A central critique concerns the composition and execution of public budgets. Analysis by the International Monetary Fund (2012) suggests that budgetary allocations in the region are often marked by inefficiencies, where significant expenditures labeled as "capital projects" fail to yield the intended transformative impact on infrastructure or productive capacity. This misalignment implies that the accumulation of debt is not consistently tied to growth-enhancing investments. The tangible consequences of these fiscal practices are reflected in a troubling macroeconomic trajectory for the region, characterized by stagnating or declining per capita income, heightened levels of food insecurity, and accelerating environmental degradation.

In the Nigerian context, the persistent expansion of fiscal deficits has been identified as a primary driver of the economic challenges that began roughly twenty years ago. This trend contributed to a cycle of excessive borrowing, debt instability, high inflation rates, and a subsequent decline in both investment and overall growth. Historical data illustrates this sharp upward trajectory: the budget deficit grew from ₦3,902.10 million in 1981 to ₦15,134.70 million by 1989. However, the most dramatic surges occurred in the late 90s and early 2000s, with figures climbing to ₦133,389.30 million in 1998 and reaching ₦301,401.60 million by 2002. A brief period of fiscal restraint followed between 2003 and 2006, during which the deficit saw a consistent reduction, dropping from ₦202,724.70 million to ₦101,397.50 million [8].

Central Bank of Nigeria statistical bulletin [9] shows the debt profile is also very high, the combined external loan stock (both FG and states) stood at N 57208.06 billion as of December 2018. Recent trends show a troubling rise in the nation's deficit-to-GDP ratio, which climbed from 1.69% in 2015 to 2.37% just a year later. This upward momentum continued, reaching 2.85% in 2018 and 2.92% by 2019. Projections from the Federal Government remain high, with an expected deficit-to-GDP ratio of 5.03% for the 2023 fiscal cycle (Federal Ministry of Finance of Nigeria). Several factors contribute to this chronic deficit, most notably the escalating costs of fiscal deficits are government bureaucracy, the cost of providing critical infrastructures and shortage of revenue generation, etc. These arguments have led to the investigation of the impact of fiscal deficit on economic growth in Nigeria.

Economic scholars, such as [22], have noted that Nigeria's historical debt profile has been a significant driver of inflationary pressure and exchange rate instability. These factors combined to diminish the nation's productive capacity, employment rates, and capital formation—the very elements debt was originally intended to bolster. To mitigate these adverse effects, Nigeria has historically adopted various international policy frameworks. A primary example is the Structural Adjustment Program (SAP) introduced in 1986, which aimed to

facilitate non-inflationary growth, diversify the production of tradable goods, and achieve a sustainable external debt profile. Additionally, the government implemented measures to curb debt-related volatility, such as halting external borrowing unless loans were secured on highly concessional terms or designated for projects capable of generating foreign exchange for repayment.

Furthermore, A pivotal shift occurred on October 4, 2000, with the creation of the Debt Management Office (DMO). This specialized agency removed the burden of public debt management from the Central Bank of Nigeria (CBN). The DMO was established to provide the Federal Government with a clearer understanding of the risk-cost trade-offs inherent in its debt structure. Despite these institutional advances, the Nigerian economy has continued to grapple with challenges such as low productivity, high import dependency, and persistent unemployment.

2. Literature Review

2.1. Conceptual Review

A fiscal deficit occurs when a government's total expenditures outpace its generated revenue within a specific period [25]. Simply put, it represents the gap between total government outlays and total receipts, serving as a primary indicator of the borrowing requirements needed to sustain national operations [26]. The "conventional deficit" remains the standard metric in economic analysis. This figure calculates the difference between total government spending and revenue, specifically excluding changes in public debt [24]. When evaluated on a cash basis, this deficit is often synonymous with the "public sector net borrowing requirement." It is, in general, more restrictive than the deficit measure implicit in laws requiring balanced budgets, which typically balance the budget by including the sale of government bonds as ordinary revenue (i.e., "above the line" that separates deficit-determining items from those that finance the deficit). [16] opined that fiscal deficit policy is the stringent measure than implicit budget balance requirements, which often categorize the sale of government bonds as ordinary revenue. By adjusting its level of spending and tax revenue, the government can affect the economy by either increasing or decreasing economic activity in the short term. For example, when the government runs a budget deficit, it is said to be engaging in fiscal stimulus, spurring economic activity, and when the government runs a budget surplus, it is said to be engaging in a fiscal contraction, slowing economic activity. A government runs a fiscal deficit when its budget is structured such that total outlays surpass total receipts. The magnitude of this deficit is precisely the difference between expenditure and revenue, representing the sum that must be financed through borrowing or other means [7].

The deficit budget is a recognized and often strategically employed instrument of fiscal policy, utilized by governments to stimulate a nation's economic growth. This approach to

public finance gained prominence following major global disruptions, such as the two World Wars, the oil crises of the 1970s, and more contemporary fiscal and monetary emergencies [18]. Governments typically finance a deficit through three primary channels: raising taxes, borrowing from domestic or international markets, or monetization—a process often described as an "inflation tax." Among these, borrowing is the most prevalent method, frequently executed through the issuance of government bonds.

Within economic literature, debt is formally defined as a future claim on resources, arising from a present obligation of the debtor to the creditor. This liability is central to understanding fiscal policy, as public debt represents the cumulative total of a government's past borrowing to finance budget deficits. The transition from a simple contractual obligation to a macroeconomic variable is critical; it shifts the analysis from a balance sheet entry to a potential catalyst for growth or a constraint on future fiscal space, depending on its size, cost, and application [5]. Debt can also be defined as a commitment that can be enforced through legal action, requiring the debtor to pay money to the creditor [11]. It is a resource or money that is used in a company or nation but was not provided by the owner and is not their property in any way. A liability represented by a financial instrument or other formal counterparts can also be referred to as 'debt'. Debt is an obligation that forces one party, the debtor, to pay another party, the creditor, money or other agreed-upon value. Loans, bonds, notes and mortgages are all examples of debt. The phrase can also allude to moral obligations and other non-monetary exchanges in a metaphorical sense. Contractual provisions governing the amount and timing of principal and interest payments often apply to debt [3].

A government incurs public debt when it borrows money. Internal and external debt are two main types. When the government borrows money from the home market, the debt is internal. When the government borrows money from the international market to support domestic investment, the debt is external. Public debt is one method of financing the government. Although this strategy is not the only way the government may alter how it operates, it can also generate funds to service its debts [12]. Public debt is widely regarded as a critical macroeconomic indicator that shapes a country's profile and creditworthiness in the global financial system. Its management is a key determinant of foreign direct investment (FDI) flows, as investors closely assess sovereign risk. Prudent debt management can foster economic growth and stability by facilitating efficient resource mobilization at lower borrowing costs while minimizing exposure to financial volatility [10].

As a primary instrument for financing government expenditures, public debt represents a fundamental fiscal obligation—where the state, as the debtor, pledges future resources to creditors. However, it is not the sole mechanism available. Governments may alternatively resort to debt monetization

(often termed "printing money"), wherein the central bank finances deficits by purchasing government securities. While this can eliminate immediate interest costs, it carries significant risks, notably inflationary pressure that erodes the real value of currency, effectively imposing a different kind of burden on the economy [15].

Economic growth can also be defined as a periodic increase in a nation's output, which is most commonly measured by the gross domestic product (GDP) of the nation. The benefits stemming from economic growth are wide-ranging [13]. Economic growth remains one of the macroeconomic goals of every government and there are several studies on the subject. [13] suggests that to achieve economic growth, two options are available, namely: using resources 'extensively' (that is, producing more by using more of the available resources) or 'intensively' (that is, producing more while using the same number of available resources). However, the key to sustainable economic growth is to use resources 'intensively', that is, to realize productivity gains.

2.2. Empirical Review

Several studies have previously empirically investigated on the subject matter and are discussed:

Hassan, *et.al.*, utilized the ARDL methodology to analyse the dual role of public debt in Nigeria's economy. Their findings reveal a nuanced relationship: while the stock of both domestic and outside debt showed a positive long-run association with economic growth, the burden of servicing this debt—especially outside debt—emerged as a significant constraint. Hence, they recommended prudent borrowing for high-return projects, restructuring domestic debt, prioritizing concessional loans, and enforcing transparency [14].

Adamu and Ibrahim in their recent investigation using long-run models revealed that while public borrowing occurs, no long-term correlation exists between public borrowing and GDP growth likely because the borrowed funds are diverted to non-productive sectors (recurrent expenditure) [2].

Amade and Oyigebe investigated Nigerian data spanning forty years. Using ARDL, they discovered budget deficits had exerted remarkable impact on Nigeria's economic growth. Thus, they recommended direct fiscal deficits towards productive investments (e.g., infrastructure, electricity, FDI) and practice inflation targeting for price stability [6].

Ogwueleka, *et.al.*, examined the impact of deficit financing (DF) on Nigeria's economic growth from 1984 to 2019. To capture the objectives of the study, secondary data were sourced and relevant methods of analysis were adopted which include unit root test and ARDL bound testing. The findings revealed that DF has a positive impact on each of the directly productive sectors (DPS) in Nigeria. Given the empirical results on average, the study concludes that Nigeria needs to apply more disaggregated measures in the management of deficit financing and recommends that the Nigerian government

should prioritize fixing the economy concerning deficit financing, sector and economic growth by investing more in viable sectors that can keep abreast of others [23].

Nanak examined the implications of public sector budget deficit financing on economic growth in Nigeria from 2003 to 2018. The result for external financing exhibited an inverse relationship with the growth rate of the Nigerian economy but the coefficient of EXDF was not statistically significant. It was recommended that government should weigh the risks associated with external borrowing as well as consider the medium and long-term repercussions of a possible default on debt servicing [21].

The international literature further clarifies the complex relationship between budgetary imbalances and national output. [17] applied a panel data framework to Eurozone economies from 1995 to 2015, determining that the fiscal deficit-to-GDP ratio maintains a statistically significant and positive correlation with economic performance.

In the Southeast Asian context, [4] examined Malaysian data from 1980 to 2017 using an Ordinary Least Squares model. Their findings demonstrated that fiscal deficits exerted a favourable influence on GDP, particularly highlighting how deficit spending acted as a vital economic stimulant during the 1997–98 and 2008–09 financial crises.

Regarding the Nigerian landscape, [20] investigated the utility of deficit financing as a mechanism for enhancing economic development between 1986 and 2019. Utilizing the Human Development Index (HDI) as a development proxy alongside government expenditure and budget deficits, they applied Autoregressive Distributed Lag (ARDL) and Granger Causality techniques. Their results indicated that while budget deficits and public spending had a positive effect, the overall influence remained marginal. Crucially, the study identified a unidirectional causal flow from government spending to economic development, leading the authors to recommend a more stringent institutional framework and intensified legislative oversight to monitor the allocation of budgeted funds.

Finally, [27] explored these dynamics using ARDL estimation for various Nigerian economic indicators. Their analysis revealed that in the long run, interest rates, gross domestic savings, and budget deficits share a significant relationship with economic growth. However, the short-run data suggested that only gross domestic savings and the budget deficit served as active drivers of growth. The study concludes by affirming the substantial role that strategic budget deficits play in shaping the Nigerian economic trajectory.

3. Method of Research

3.1. Research Design

The research design used in this study is *Expost-facto* research. The statistical association between dependent and independent variables is described in ex-post facto research de-

sign with the goal of establishing a causal relationship between them. It also combines a theoretical review with empirical literature to test hypotheses about cause-and-effect relationships.

3.2. Sources of Data Collection

The data used primarily consisted of secondary data annual collected from publications of Central Bank of Nigeria (CBN) statistical bulletin spanning from 1990 to 2024 (34 years). The data-set comprises aggregate Real Gross Domestic Product (RGDP) which was used as a proxy for economic growth; while government budget deficit and debt-to-gross domestic product ratio were considered as proxies for fiscal deficit indicators in Nigeria.

3.3. Methods of Data Evaluation

Pre-estimation tests like unit root test using Phillips Perron (PP) to ascertain the stationarity of the data before carrying out cointegration test.

After conducting stationarity diagnostics, it is expedient to ascertain if the data-set have long-run association. Hence, cointegration test was carried out to capture equilibrium association.

The Fully Modified Ordinary Least Squares (FMOLS) estimator is selected for its robust statistical properties in analyzing cointegrated relationships. It yields asymptotically unbiased and efficient estimates with a mixture normal distribution, facilitating reliable hypothesis testing using standard asymptotic Chi-square inference. The estimator's strength lies in its correction mechanism, which employs preliminary estimates of long-run covariance matrices to address serial correlation and endogeneity in the residuals. This modification effectively eliminates nuisance parameters, a distinct advantage over alternative techniques like Dynamic Ordinary Least Squares (DOLS). While DOLS incorporates lagged and leading terms, FMOLS directly adjusts the variables, providing a more direct solution to the correlation between stochastic regressors and cointegration errors.

3.4. Model Specification

The explicit linear regression equation is given as:

$$RGDP_t = \alpha_0 + \alpha_1 GBD_t + \alpha_2 PUD_t + u_t$$

Where;

α_0 = The intercept or autonomous parameter estimate

$\alpha_1 - \alpha_2$ = are the slope of the coefficients of the independent variables to be determined

$RGDP_t$ = Real Gross Domestic Product (Proxied economic growth/expansion).

GBD_t = Government Budget Deficit in Nigeria

PUB_t = Public Debt in Nigeria

μ_t = Error term or residual

The FMOLS model is specified thus:

$$rgdp = \alpha_0 + \alpha_1 gbd + \alpha_2 pub + \sum_{i=1}^m \alpha_3^i gbd_i + \sum_{i=1}^m \alpha_4^i gbd_{i+1} + \sum_{i=1}^m \alpha_5^i gbd_{i-1} + \sum_{i=1}^m \alpha_6^i pub_i + \sum_{i=1}^m \alpha_7^i pub_{i+1} + \sum_{i=1}^m \alpha_8^i pub_{i-1} + \mu_t$$

4. Results and Discussion

4.1. Result of the Unit Root

The result of the unit root test is presented in Table 1.

Table 1. Unit Root Results.

ADF Test Statistics			
Variables	ADF-Value	Critical Value	Order of Integration
RGDP	-2.713237**	-1.951332	I (1)
GBD	-3.781691**	-2.954021	I (1)
PUB	-8.998779*	-3.646342	I (1)

Note: *, and ** represents 1% and 5% level of Significance

Source: Researcher's Compilation using EViews-12 (2026)

From Table 1, it could be observed that all the 3 variables of interest were found stationary at first difference form, and are integrated at order one {i.e., I (1)}. At this order of integration, gross domestic product test statistics of -2.713237 was found to be greater than the critical value -1.951332 at 5% level of significance. Government budget deficit had a test statistic of -3.781691, and was found to be greater than the critical value of -2.954021 at 5% level of significance. Furthermore, public debt also had its test statistic of -8.998779 greater

than its corresponding critical value of -3.646342 at 1% level of significance.

4.2. Result of Cointegration

The result for the cointegration is found in Table 2, which showed that there is long run equilibrium relationship among the variables used in the model after first differencing, using the p-value at 10% level of significance.

Table 2. Cointegration Result.

Engel and Granger Cointegration		
	t-Statistic	Prob.
Residual (Error Term)	-1.754036	0.0927

Source: Researcher's Computation Using EViews-12 (2026)

With the establishment of cointegrating relationship, we used the Fully Modified Ordinary Least Square (FMOLS) estimation technique to obtain the long run elasticity coefficients as presented in Table 3.

4.3. Regression Result and Test of Hypotheses

Table 3. Regression Result.

Variable	Coefficient	Std. Error	t-Statistic	P-value
GBD	-21.07952	4.516945	-4.666766	0.0001
PUD	0.829949	0.605726	1.370172	0.1805
C	15040.67	7051.48	2.132981	0.041
R-squared	0.92562			
Adjusted R-squared	0.92082			
Long-run variance	1.11E+09			

Source: Researcher's Computation Using EViews-12 (2026)

The analytical results were evaluated to determine the model's overall explanatory power. The coefficient of determination reached 0.92562, implying that the combination of public debt and the national budget deficit accounts for approximately 92% of the fluctuations observed in economic expansion. The remaining 8% of variance is attributed to external factors captured by the stochastic error term.

4.4. Test of Hypotheses

The hypotheses were tested by using multiple linear regression and determined using p-values of the t-statistics (or t-value). The rejection/ acceptance criteria were that, if the p-value is less than 0.05, we reject the null hypothesis. But if it is more than 0.05, the null hypothesis is not rejected.

4.4.1. Assessment of Hypothesis One

H₀₁: Government budget deficit does not significantly influence Nigerian economic growth.

According to the analysis result in Table 3, the t-value for the link between economic expansion and the budget deficit is -4.666766, with a corresponding p-value of 0.0001. Since the p-value is well below the 5% significance threshold ($0.0001 < 0.05$), we reject the null hypothesis. The evidence indicates that the budget deficit exerts a remarkable significant and negative pressure on Nigeria's economic growth.

4.4.2. Assessment of Hypothesis Two

H₀₂: Public debt has no meaningful impact on Nigeria's economic growth.

The estimates from the regression result in Table 3 revealed that the calculated t-value for the relationship between public debt and economic growth is 1.370172, with an associated p-value of 0.1805 at 95% confidence level. This implies p-value > 0.05 , i.e., $0.1805 > 0.05$. Since the prob. Value is more than 5% ($p > 0.05$), we accept the null hypothesis (H₀₂). This

shows that public debt doesn't exert strong effect on Nigeria's economic growth.

4.5. Discussion of Findings

The coefficient and probability values revealed that Government Budget Gap (GBD) has significant and negative influence on economic growth in Nigeria and this implies that a unit increase in budget deficit leads to a 21.08-unit decrease in RGDP. This finding agrees with the work of [14] who found that debt servicing has a significant negative impact. This supports the findings of this paper by suggesting that the "cost" of the debt (which feeds back into the budget deficit) is what ultimately constrains the fiscal space and hinders growth. Conversely, [6] findings argues that public deficits had a substantial impact on growth, but unlike this study's result, their recommendation to "direct deficits toward productive investment" implies a belief in the stimulative power of deficits.

The highly significant negative coefficient further suggests that Nigeria's persistent budgetary imbalances are counterproductive to growth. In Nigeria, deficits are often financed through the "Ways and Means" advances from the Central Bank or heavy domestic borrowing. This often leads to inflation and "crowding out" the business sector, as financial institutions prioritize giving to the government than to local businesses. Historically, Nigerian deficits have been driven by recurrent expenditure (salaries and overheads) rather than capital investments. When you borrow to "eat" rather than to "build," RGDP inevitably suffers.

Interestingly, Public Debt shows a positive but statistically insignificant relationship on economic growth in Nigeria. This suggests that while debt isn't currently hampering or suppressing growth in this specific model, it isn't helping it either. It supports the Debt Overhang theory: once debt reaches a certain level, every new Naira borrowed goes toward servicing old interest rather than stimulating new growth. With Nigeria's

debt-to-revenue ratio hovering near 90-100%, the nation appears to be at a "Debt Overhang" tipping point. Debt is no longer a tool for growth, rather, it has become a neutral or slightly burdensome weight that is primarily managed through more borrowing, creating a circular fiscal trap. This finding is in tandem with [21] results which strongly mirrors same results. He found that financing deficits through "Ways and Means" (Central Bank borrowing) has a negative impact on growth. His finding that external financing was statistically insignificant directly supports your insignificant PUD result.

5. Conclusion

This research utilized the Fully Modified Ordinary Least Squares (FMOLS) technique to explore the long-term dynamics between fiscal deficits and economic performance in Nigeria. The specified model demonstrated robust explanatory power, with the independent variables accounting for approximately 92.6% of the variations in Real GDP, indicating a strong fit.

The empirical findings offer critical insights. A central conclusion is that Government Budget Deficits (GBD) exert a statistically relevant negative influence on Nigeria's economic performance. This result strongly supports the "crowding-out" hypothesis, suggesting that government borrowing—often directed toward recurrent rather than capital expenditure—reduces the availability of credit for the more productive private sector, thereby stifling long-term expansion. Interestingly, the study found that Public Debt (PUD) itself was statistically insignificant as a driver of growth. This implies that the mere accumulation of debt, without concurrent improvements in institutional quality and its channelling into productive investments, fails to act as a catalyst for economic progress.

Finally, the analysis underscores the urgent need for a strategic reorientation of Nigeria's fiscal policy framework. To transform fiscal policy into a genuine instrument, the government must prioritize revenue mobilization and expenditure efficiency. This entails ensuring that fiscal deficits are not a permanent feature but are strategically deployed to finance structural transformations that enhance the economy's productive capacity.

6. Recommendations

Based on the analysis and conclusions of this study, the following policy recommendations and strategic directions are proposed:

The government must return to the 3% deficit-to-GDP limit mandated by the Fiscal Responsibility Act. Deficits should be "cyclical" (used only during downturns) rather than "structural" (a permanent feature of the budget). Also, to stop the reliance on deficit financing, the tax-to-GDP ratio must be improved through digital collection methods and by bringing the informal sector into the tax net.

Future deficits should be legally tied to specific, self-liquidating capital projects (e.g., power plants, rail) rather than funding government overheads. Lastly, the Central Bank's financing of government deficits must be strictly capped to prevent inflationary growth and the erosion of the private sector's credit access.

Abbreviations

CBN	Central Bank of Nigeria
IMF	International Monetary Fund
FMFN	Federal Ministry of Finance, Nigeria
DMO	Debt Management Office

Author Contributions

Ropheka Emerson Bot: Conceptualization, Data curation, Formal Analysis, Methodology, Resources, Writing – original draft, Writing – review & editing

Conflicts of Interest

The author declares no conflicts of interest.

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