

Impact of Budget Deficit and Foreign Direct Investment on Nigerian Economy

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Abstract: This study investigated the impact of budget deficit and foreign direct investment on Nigerian economy from the period 1990 to 2022. Exchange rate, foreign direct investment, government deficit financing, inflation rate and real gross domestic product were used as measures and dimension respectively. Data used were sourced from World Bank development indicators (WDI) and CBN. The E-view Statistical Software was used to run analysis. The Augmented Dickey Fuller and Philip Peron of Unit root tests were employed. The unit root tests show that RGDP, EXR, FDI and GDF variables tested are all stationary after first difference while inflation rate was stationary at level. The method of analysis used was Autoregressive distributed lag (ARDL). The results of the estimates revealed that in the long run, exchange rate (EXR), foreign direct investment (FDI), government deficit financing (GDF) have positive and significant impact on real gross domestic product while inflation rate (INFR) has negative impact on real gross domestic product in the Nigerian economy. The study recommends amongst others that since foreign direct investment has positive and significant impact on the Nigerian economy, therefore, Nigerian policy makers should devise strategies and policies that would attract significant investments inflow into the country. Also, since government deficit financing has positive impact on the Nigerian economy, therefore, fiscal deficit that are recorded should be channelled to productive investment such as roads construction, provision of electricity, improved health system to mention but three that would serve as incentives to productivity through the attraction of foreign direct investments.

Keywords: Budget deficit, Foreign direct investment, Nigerian economy.

INTRODUCTION

For Nigeria as a developing country, Foreign Direct Investment (FDI) has been considered as a way of transferring technology and capital from other developed as well as less developed countries to the domestic economy. Foreign Direct Investment (FDI) is one of the major channels through which technology is transferred (Solomon & Eka, 2013). Melnyk, et al. (2014) opined that when Foreign Direct Investment comes to a domestic country that firms receive a competitive advantage due to the usage of new knowledge, experience, ways of production and management.

Budget deficit exists when government current expenditure exceeds her current expected income. Right from 1990 to 2018, budget deficits financing has been a recurring feature of public sector financing in Nigeria. The demand-side economics put so much emphasis on the need for expansion in government expenditures even above current income, especially during depressions when the economy is suffering from insufficiency of active demand, like the Great Depression of 1929, and most recently, the 2008 global financial and economic crisis. This will thereby increase the demand

for productive output, resulting in reflation of the economy and employment creation (Ogboru, 2010). In the past, it has been observed that no economic policy problem has generated more debate than the effects of government budget deficits. Extraordinary fiscal inequities have occurred in different nations' economies. Such fiscal inequalities also influenced the extent of the challenges and led to new developments in the global economy in different countries. Many economic planners were puzzled by the controversial nature of budget deficits. These fears about fiscal deficits led in all economic sectors to disruptive dislocation or movements (Shojai, 1999). Budgeting is a policy process that take economic into account. Budgetary actions require two phases which are expenditure and income; the revenue side is accountable for government resources in the form of taxation by individuals or the private sector. While spending is concerned about how the government should allocate its resources to its public sector. Budget deficits were higher than government revenue, where public spending is higher. On the other hand, when public receipts exceed public expenditure between public revenues and public expenditure, a budget surplus existed and borrowing could finance such shortcomings. In promoting economic activity in Nigeria, there was a deliberate gap. Different ideology politicians argue that cutting deficits is critical to Nigeria and other major economies ' future Awosusi, et al. (2020). The budget deficit has had an adverse impact on these macroeconomic variables (Adebayo & Akinsola, 2021)

The most trending phenomenon in most developing countries is that, the public sector plays a dominant role in initiating and financing economic growth. One of the most challenging issues of both developing and developed countries of the globe is sustainable economic growth and development. One of the most significances of an effective running of fiscal and monetary policies is to control inflation, reduce unemployment, reduce balance of payment deficit and sustain economic growth. A deficit does not simply stimulate demand. If private investment is stimulated, that increases the ability of the economy to supply output in the long run. Also, if the deficit is spent by the government on such things like basic research, public health, infrastructure, and education, that can also increase potential output in the long run. What drives economic growth is basically improvement in productivity, which involves producing more goods and services with the same inputs of labour, capital, energy and materials (Najid, 2013). The economy of Nigeria has been faced with the challenges of the adoption of the policy of budget deficits with regard to its effectiveness and the accumulation of debt, the justification for growth notwithstanding. Government deficit spending is a central point of controversy in economics, there have been divergent views by different economist. Different economic research has over the years revealed that budget deficit results in a number of economic implications, particularly for economic growth and development. Also, a large number of macro-economic aggregates are affected in the process of budget deficit. The high level of debt servicing hindered the country from carrying out large volume of domestic investment, which would have enhanced growth and development. As a result of the debt forgiveness or pardon granted to Nigeria, it would have been expected that the economic process of the country would increase. In spite of the large volume of research on this subject matter, there are still contradicting evidences in the literature regarding the question as to how Foreign Direct Investment (FDI) relates to economic growth and development. According to Eller et al. (2014), a two-way interaction has been discussed in the literature of Foreign Direct Investment (FDI)-growth relationship. On one hand, Foreign Direct Investment is being seen, by many, as an important element in the solution to the problem of scarce local capital and overall low productivity in many developing countries. Hence, the flow of foreign direct capital is argued

to be a potential growth-enhancing player in the receiving country. This view has been challenged by several authors. For example, Carkovic and Levine (2012) show that there is no robust impact from FDI on growth if country-specific level differences, endogeneity of foreign direct investment inflows and convergence effects are taken into account.

Nevertheless, the effects of budget deficit and foreign direct investment on Nigerian economy can be measured with different proxies. For this study, government deficit financing, foreign direct investment, exchange rate, inflation rate and real gross domestic product were used as measures and dimension of the dependent and the independent variables. Based on this, this paper seeks to empirically investigate the impact of budget deficit and foreign direct investment on Nigerian economy. Interestingly, no study has investigated the impact of budget deficit and foreign direct investment on Nigerian economy using the above measures and dimensions at the same time. These issues give credence to this study.

This article is organized as follows; the abstract, the introductory part, the literature reviewed which includes conceptual clarifications, theoretical framework and empirical review. The methodology, which contains the model design, model specification and empirical result discussions. This work was concluded with the conclusion and recommendations.

LITERATURE REVIEW

Conceptual Framework

Foreign Direct Investment: Foreign Direct Investment basically involves the transfer of resources, including capital, technology, and management and marketing expertise. Odozi (2014), opined that resources so transferred most times extend the production capabilities of the recipient country. The concept of Foreign Direct Investment refers to the movement of capital which has to do with control and ownership of a country's firm in a different or another country. The concept behind a foreign direct investment and economic growth and development has remained on a bilateral relationship between the multinationals and the host communities and how development is appraised in these host communities. Inputs are provided for by the Multinationals at an affordable cost to buyers of downstream. This is what is in practice in developing countries in which Nigeria is a part. The nationals of these countries in question built their capacity in several sectors and with technical and managerial positions in multinational enterprises. Rents are received by host communities from multinational enterprises. It is argued that by attracting multinational firms, the host economy captures a portion of the rents that these firms generate (Glass & Saggi, 2011).

The Concept of Budget Deficit: when the total expenditures of government exceed its total revenue, it is known as budget deficit. It is a situation that arises when the money going out is more than the money coming in. It is used mainly with government spending rather than private spending. Budget deficit policy is a usual instrument of fiscal policy targeted at increasing the rate of economic growth of a country, (Stevan, 2010). The term budget deficit is most times a deliberate effort aimed at stimulating the economy by reducing tax rate but increase government

expenditures. Imobighe (2012) sees budget deficit as a condition whereby government excess funds of outlay over receipts of revenues for a given time period are catered for through public borrowing. Budget deficit is financed in three different ways; – taxes, borrowing and monetization. Borrowing is the most common way of deficit finance and it is done by issuing of government bonds (Stevan, 2010). Budget deficit bothers on fiscal policy. It thus means, in order to understand budget deficit, one must understand fiscal policy which basically is a key instrument of macroeconomic stability.

The Concept of Economic Growth: Todaro defined defined economic growth as a rise in output of goods and services of a nation or an increase in the rate at which output of goods and services increase yearly in real terms. Gross domestic product is used to measure the economic growth of a country. The Gross domestic product is the value of goods and services in a country measured in monetary terms over a period of time usually one year, (Todaro, 2000). For this study, economic growth shall be seen as a concept that is measured by real gross domestic product (RGDP).

Theoretical Framework

Keynesian Theory of Budget Deficit

John Maynard Keynes in 1936 introduced the theory of budget deficit Keynes (1936). His theory on budget deficit was based on two main assumptions which are; First, the theory assumes the possibility that some resources are not unemployed. Secondly, it presupposes the existence of a large number of myopic liquidity constrained individuals.

Keynes in 1936, opined that enormous public debt is seen as an asset rather than a liability for a country. He asserted that constant expenditure is key to fostering rapid economic growth and development of a nation. Keynes' view is not in tandem with that of the classical school. The classical economists opposed the government intervention in the economy. Considering what happened during the great depression, Keynes, strongly hold on to his views that government intervention in the economy is key to achieving economic growth and development in a country. Yellen (2012), contested when there is a rise in aggregate demand it leads to profitability of private investments which brings about increase in the level of investment at any given rate of interest. Therefore, budget deficit stimulates total savings and investment despite the fact that they bring about increase in interest rate. Yellen concluded that evidences abound that deficit has not crowded out investments; instead there is a crowd in. The Keynesian school proposes a positive inter-relationship between deficit financing and economic growth and development in a country.

Empirical Review

Adam (2010) examined the relationship between budget deficit and growth for a panel of 45 less developed countries. Error Correction Model was used as method of analysis. The findings revealed that there exists a non-linearity in the relationship between growth and the budget deficits for the sample of less developed countries. Abell (2010) studies the correlation between budget deficit and Mmacroeconomic Pperformance of US using VAR for the period 1980 to 2010. He found no evidence that larger government deficit cause prices to rise, spending, interest rates, or

the money stock. Koojaroenprasit (2012) analyzed the effects of FDI on economic growth of South-Korea using time series data for the period 1980 to 2009. Regression analysis was adopted in the study. This study discovered a positive and strong effect of foreign direct investment South-Korean economy. Oluwabukola and Eniola (2013), assessed and investigated the impact of fiscal deficits on the economy of Nigeria. The results show that fiscal deficits have made important contributions to economic growth and development of the country and it concludes that increase in government expenditure does not have negative impact on consumption but otherwise increases private investment. Huntley (2014), investigated the long run impact of government budget deficits on private domestic investments. The results reveal that any dollar increase in the budget deficits, the impact on private domestic investment ranges from a reduction of fifteen cents to a decrease of fifty cents, with a central estimate of a decrease of thirty-three cents. This study did not put into consideration some other means of financing government deficits by embarking on more money

Uwubanmwun and Ogiemudia (2016) investigated the impact of FDI on economic growth in Nigeria using secondary data from the period 1979 - 2013. The data were modeled by using ECM model. The result reveals that foreign direct investment has great impact on the economy of Nigeria economy in both the long run and short run but has an insignificant negative effect on the Nigeria economy in the long run. Ali et al. (2018), examined the effect of budget deficit in Nigeria. The time series data from the statistical bulletin of CBN. The method of analysis used was the autoregressive distributed lag technique. Domestic private investment, foreign currency, interest-rate and shortfall finance are the variables used. The results show that government deficits financing for many years had significant effects on Nigeria's output growth. Emefiele, et al (2019) investigated government deficits budget and its impacts on Nigerian economic growth covering the time period from 1990 – 2016. He adopted Johansen co-integration as a unit of analysis. The result of the study reveals that budget deficits negatively impacted on economic growth in Nigeria. The study concluded that negative impact does exist between budget deficits and economic growth because government is short of resources required to meet up with their expenditures in the long-run.

METHODOLOGY

Model Design

This study adopted a quasi-experimental research design which is considered appropriate for this study because of the difficulties of the relationships that exist between the variables. The reason that informed the use of experimental design is the fact that the relationship that exist between variables are not subject to human manipulation.

Model Specification

The mathematical form of the model is expressed as

$$RGDP = F (GDF, FDI, EXR, INFR) \quad 1$$

Where RGDP = Real gross domestic product

GDF = Government Deficit Financing

FDI = Foreign Direct Investment

EXR = Exchange Rate

INFL = Inflation rate

F = Functional notation

The linear regression model based on the above functional relation is expressed as:

$$\begin{aligned}
 \text{RGDP} &= \beta_0 + \beta_1 \text{GDF} + \beta_2 \text{FDI} + \beta_3 \text{EXR} + \beta_4 \text{INFR} & 2 \\
 \Delta \text{RGDP}_t &= \alpha_{0i} + \beta_{1i} \text{RGDP}_{t-1} + \beta_{2i} \text{GDF}_{t-1} + \beta_{3i} \text{FDI}_{t-1} + \beta_{4i} \text{EXR}_{t-1} + \beta_{5i} \text{INFR}_{t-1} + \sum_{i=1}^q \alpha_1 \Delta \text{RGDP}_{t-1} \\
 &+ \sum_{i=1}^{p1} \alpha_2 \Delta \text{GDF}_{t-1} + \sum_{i=1}^{p2} \alpha_3 \Delta \text{FDI}_{t-1} + \sum_{i=1}^{p3} \alpha_4 \Delta \text{EXR}_{t-1} + \sum_{i=1}^{p4} \alpha_4 \Delta \text{INFR}_{t-1} + \text{et} & 3
 \end{aligned}$$

ECM

$$\begin{aligned}
 \Delta \text{RGDP}_t &= \alpha_{0i} + \sum_{i=1}^q \alpha_{1i} \Delta \text{RGDP}_{t-1} + \sum_{i=1}^{p1} \alpha_{2i} \Delta \text{GDF}_{t-1} + \sum_{i=1}^{p2} \alpha_{3i} \Delta \text{FDI}_{t-1} + \sum_{i=1}^{p3} \alpha_{4i} \Delta \text{EXR}_{t-1} \\
 &+ \sum_{i=1}^{p4} \alpha_{5i} \Delta \text{INFR}_{t-1} + \lambda \text{ECT}_{t-1} + \text{et} & 4
 \end{aligned}$$

$\beta_1 \geq 0, \beta_2 \geq 0, \beta_3 \geq 0, \beta_4 < 0,$

Where β_0 is the regression constant or intercept, $\beta_1, \beta_2, \beta_3, \beta_4$ and β_5 are the regression coefficients or parameters and U is the random variable. All other terms are as earlier defined.

Empirical Results and Discussions

Table 1: Augmented Dickey Fuller and Philips Perron Unit Root test of RGDP

Variable	ADF					PP				
	Level		1 st Diff		I(.)	Level		1 st Diff		I(.)
	Coeff.	5% CV	Coeff.	5% CV		Coeff.	5% CV	Coeff.	5% CV	
EXR	-0.111	-2.957	-4.676	-2.960	I(1)	-0.020	-2.957	-4.735	-2.960	I(1)
FDI	-1.568	-2.957	-6.308	-2.960	I(1)	-1.707	-2.957	-6.264	-2.960	I(1)
GDF	-1.058	-2.960	-9.020	-2.960	I(1)	-2.065	-2.960	-12.50	-2.960	I(1)
INFR	-8.912	-3.588	---	---	I(0)	-3.867	-3.588	---	---	I(0)
RGDP	-0.569	-2.957	-4.370	-2.960	I(1)	-0.662	-2.957	-4.290	-2.960	I(1)

Table 1, presents the outcome of ADF and Philip Peron of unit root tests. We adopted the Philip Peron test because of its robustness of the result in relation to structural breaks. In line with the

prepositions of Jenkins and Box (1970). Series which were not stationary at levels would be made stationary after first difference. The following series in the model were made stationary after first difference, EXR, FDI, BGTD and RGDP while INFR rate was stationary at level.

Table 2: Bound Test for RGDP Model

ARDL Bounds Test

Date: 05/19/23 Time: 15:13

Sample: 1993 2022

Included observations: 30

Null Hypothesis: No long-run relationships exist

Test Statistic	Value	k
F-statistic	7.321818	4

Critical Value Bounds

Significance	I0 Bound	I1 Bound
10%	2.45	3.52
5%	2.86	4.01
2.5%	3.25	4.49
1%	3.74	5.06

Source: Computed from E-view

The result in table 2, reveals that the F- statistics calculated of 7.321818 is higher in value than the upper bound critical value of 4.01 at 5% significant level. As a result of this result, it could be concluded that there exists a long run relationship amongst the series the series of RGDP model. So, there is a long run relationship amongst the variables in the model.

Table 3: ARDL-ECM Short-run Results for RGDP model

ARDL Cointegrating And Long Run Form
 Dependent Variable: RGDP
 Selected Model: ARDL(1, 2, 3, 2, 0)
 Date: 05/19/23 Time: 15:14
 Sample: 1990 2022
 Included observations: 30

Cointegrating Form				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(EXR)	0.108904	0.195807	0.556181	0.5853
D(EXR(-1))	-0.603618	0.209719	-2.878217	0.0104
D(FDI)	-8.822790	4.987973	-1.768813	0.0949
D(FDI(-1))	-13.721397	5.258318	-2.609465	0.0183
D(FDI(-2))	-13.905614	6.327817	-2.197537	0.0421
D(GDF)	0.001386	0.000738	1.877624	0.0777
D(GDF(-1))	-0.001183	0.000737	-1.604930	0.1269
D(INFL)	-0.045481	0.394710	-0.115227	0.9096
CointEq(-1)	-0.453089	0.108415	-4.179216	0.0006

Cointeq = RGDP - (1.4540*EXR + 43.0096*FDI + 0.0065*GDF -0.1004*INFL -26.3862)

Source: Computed from E-view

Explanation of estimated short run for RGDP model

The result of the short – run dynamic regression of the model is presented in table 3. The regression result indicates that in the short run, FDI and INFL coefficients have negative relationship with RGDP but positive relationships for EXR and GDF both in lg one. What this means is, a unit increase in foreign direct investment would reduce real gross domestic product by -8.822790 in the short run all things being equal. It was also observed that a unit increase in inflation rate would reduce real gross domestic product by -0.045481 in the short run ceteris paribus. Also, a unit increase in exchange rate would lead to an increase in gross domestic product by 0.108904 in the short run, all things being equal. A unit increase in the coefficient of government deficit financing will increase gross domestic product by 0.001183. the results reveal that EXR, FDI, are the coefficient that are only statistically significant in lag one. What this portends is, in the short run the coefficients of exchange rate, foreign direct investment, government deficit financing and inflation rate do not meaningfully impact on real gross domestic product in Nigeria.

The ECM turned up with a negative value of -0.453089 as the ECM coefficient which suggests 29% speed of adjustment. This means that approximately 45% of discrepancy in the previous year is adjusted for the current year.

Table 4: ARDL Long Run Regression for RGDP Model

Long Run Coefficients				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
EXR	1.453961	0.272450	5.336609	0.0001
FDI	43.009579	4.901592	8.774614	0.0000
GDF	0.006472	0.003386	1.911300	0.0730
INFL	-0.100380	0.870268	-0.115344	0.9095
C	-26.386178	39.841336	-0.662281	0.5167

Source: Computed from E-view

Explanation of the Estimated Long-run for the Model

The result of the long run regression estimates for RGDP model is presented in table 4. The results reveal that the coefficient of exchange rate (EXR) is positively signed and statistically significant. A unit increase in the coefficient of exchange rate would increase real gross domestic product (RGDP) by 1.453961. It was also observed that the coefficient of foreign direct investment is positively signed and statistically significant. One percent increase in foreign direct investment would increase real gross domestic product by 43.009579. The results also reveal that a unit increase in the coefficient of government deficit financing would increase real gross domestic product by 0.006472. It was also observed that a one percent increase in inflation rate coefficient would lead to a decrease in real gross domestic product by -0.100380. what this portent is, in the long run, EXR, FDI and GDF positively and significantly impact on real gross domestic product (Economic growth) in Nigeria. These findings are in tandem with that of Oluwabukola and Eniola (2013) and Ali et al. (2018). But these findings are in contradiction with that of Emefiele et al. (2019).

Tables 4.1 Residual Diagnostics Test for RGDP

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	1.590193	Prob. F(2,15)	0.2364
Obs*R-squared	5.248049	Prob. Chi-Square(2)	0.0725

Source: Computed from E-view

The null hypothesis states that there is no serial correlation. Since each of the F-statistics probability value is greater than five percentage we cannot reject the null hypothesis of no serial correlation. It means that the result is good.

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.408490	Prob. F(12,17)	0.9400
Obs*R-squared	6.714331	Prob. Chi-Square(12)	0.8759
Scaled explained SS	1.005116	Prob. Chi-Square(12)	1.0000

Source: Computed from E-view

The null hypothesis states that there is no heteroskedasticity. Since each of the F-statistics probability value is greater than five percentage we cannot reject the null hypothesis of no heteroskedasticity. It thus mean that the result of the model can be taken seriously, that is the result is good.

4.2 Stability Tests for RGDP

The test is meant to test the appropriateness and stability of the estimated ECM model. This is to check if the coefficients of the model are stable and can be used for prediction. The stability test was conducted using the cumulative sum (CUSUM) and cumulative sum of square (CUSUMSQ) tests. If the plot of the CUSUM and CUSUMSQ for the model lies within the 5 percent critical bound it is suggestive that the model is stable. From our results, the model is stable.

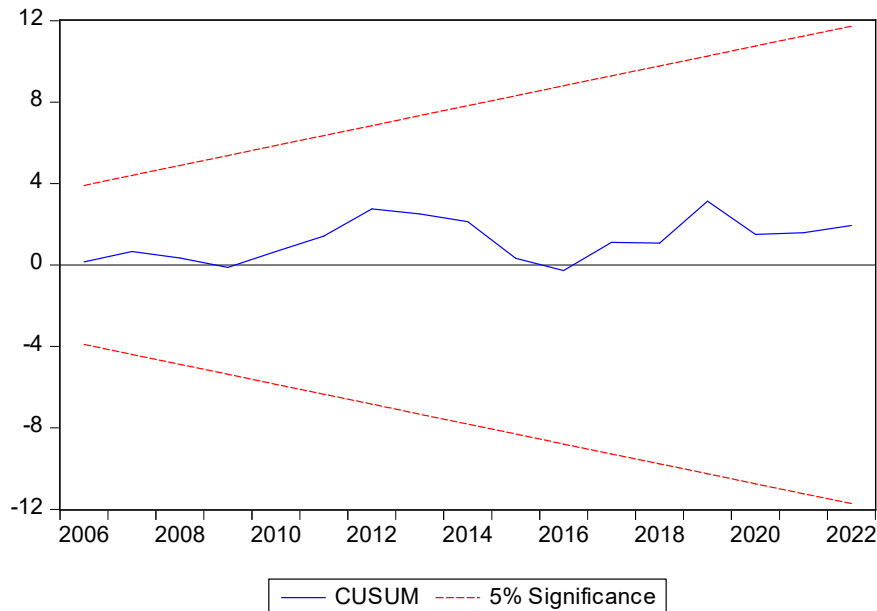


Figure 1b: Cumulative sum for the Model

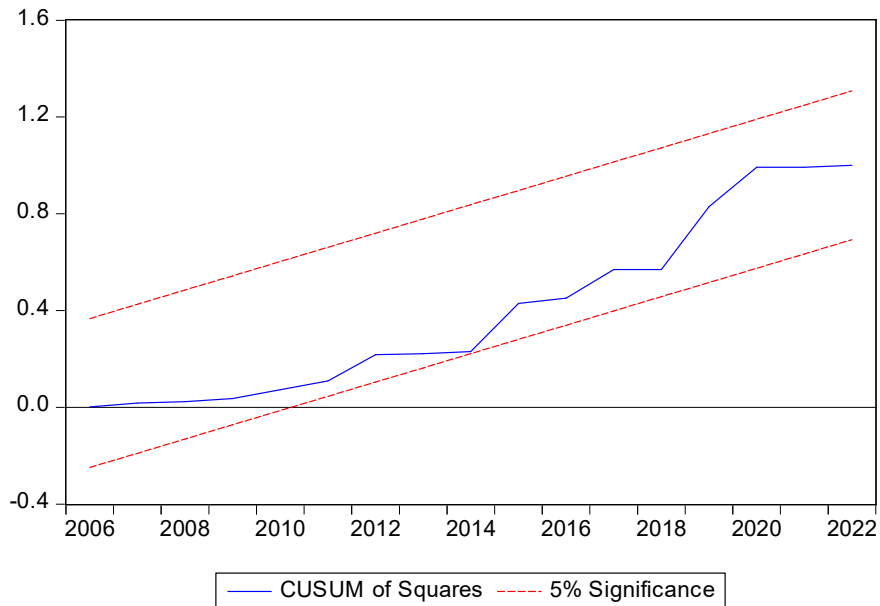


Figure 1b: Cumulative sum of Square for the Model

Conclusion/Recommendations

This paper examined the impact of budget deficit and foreign direct investment on Nigerian economy from the period 1990 – 2022. The study investigated the long run and short run relationship between the variables by using Autoregressive distributed lag (ARDL). The empirical results show that in the short run the coefficient of exchange rate (EXR), foreign direct investment (FDI), government deficit financing (GDF) and inflation rate (INFR) are not statistically significant except in lag one. Whereas, in the long run all the coefficients; EXR, FDI, GDF and INFR are statistically significant and positively impacted on real gross domestic product (RGDP) except inflation rate which is negatively signed. In summary, it means that increase in exchange rate, foreign direct investment and government deficit financing leads to economic growth in the Nigerian economy. The study recommends that since foreign direct investment has positive and significant impact on the Nigerian economy, therefore, Nigerian policy makers should devise strategies and policies that would attract significant investments inflow into the country. Also, since government deficit financing has positive impact on the Nigerian economy, therefore, fiscal deficit that are recorded should be channelled to productive investment such as roads construction, provision of electricity, improved health system to mention but three that would serve as incentives to productivity through the attraction of foreign direct investments. Based on the findings of this study which show that, there was positive relationship between budget deficits and the Nigerian economy, the Nigerian government government should display a high sense of transparency in the fiscal operations to bring about realistic fiscal deficits.

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