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IMPACT OF GOVERNMENT DEFICIT FINANCING ON GDP AND UNEMPLOYMENT IN NIGERIA

ABSTRACT

This study investigated the impact of government budget deficit financing on macroeconomic performance in Nigeria, focusing on economic growth (GDP) and unemployment (UNE) over the period 1986 to 2024. The study examines the effects of domestic government debt (DGD), foreign government debt (FGD), and exchange rate (EXR) on these key macroeconomic indicators. Employing the Dynamic Ordinary Least Squares (DOLS) estimation technique, the results reveal that domestic government debt has a significant positive impact on GDP, with a 1% increase in DGD associated with an 81.58% rise in output. In contrast, foreign government debt negatively affects GDP, reducing it by 43.02% per 1% increase. In terms of labor market outcomes, domestic debt significantly reduces unemployment by 3.42% per 1% increase, whereas foreign debt increases unemployment by 4.22%, and a 1-unit appreciation in the exchange rate raises unemployment by 0.60%. These findings suggest that internally financed deficits can stimulate economic activity and job creation, consistent with Keynesian theory. At the same time, overreliance on external borrowing may crowd out domestic investment and hinder growth, aligning with neoclassical and crowding-out perspectives. Based on the results, the study concludes that strategic domestic borrowing, efficient resource allocation, and prudent management of foreign debt are essential to enhancing Nigeria's macroeconomic performance. Accordingly, it recommends prioritizing domestic deficit financing to support growth and employment objectives, monitoring external debt terms to avoid adverse economic effects, and implementing policies to stabilize the exchange rate and support labour market resilience.

Keywords: Government Budget Deficit Financing; Economic Growth; Unemployment; Domestic Government Debt; Foreign Government Debt; Dynamic Ordinary Least Squares (DOLS).

1.0 Introduction

Government budget deficit financing, the strategic deployment of domestic government debt (DGD) and foreign government debt (FGD) to bridge fiscal imbalances, exerts distinct macroeconomic effects on output and employment (Kelvin, 2025). From a Keynesian perspective, deficit-financed public spending stimulates aggregate demand, generating multiplier effects that expand output and, through derived labour demand (Okun's law mechanism), reduce unemployment (Jallow, 2024).

Conversely, neoclassical and monetarist paradigms caution that persistent structural deficits financed through domestic borrowing bid up interest rates in loanable funds markets, crowding out private investment and depressing long-term employment (Adedokun, Adeniyi, & Olaniyi, 2024). Furthermore, excessive external borrowing elevates debt-servicing obligations and exchange rate exposure, siphoning investable resources away from growth-enhancing infrastructure (Abbasi, Amran, Rehman, & Ali, 2021; Mavodyo, 2023).

In Nigeria, recurrent fiscal deficits have evolved from cyclical revenue shortfalls, triggered by global oil shocks during the 1986 Structural Adjustment Programme (SAP), the 2008 financial crisis, the 2016 recession, and COVID-19, into entrenched structural deficits (Ngwobia, Uguru, Chika, & Iheukwumere, 2025). Over the past decade, fiscal deficits consistently exceeded the statutory 3% threshold set by the Fiscal Responsibility Act, driving public debt from ₦12.6 trillion in 2015 to over ₦134 trillion (over 40% of GDP) by 2024, with domestic debt comprising over 60% of the total portfolio (Debt Management Office, 2025; AfDB, 2025). In spite of this sustained borrowing, annual real GDP growth averaged an anaemic 2.5% post-2016, while structural unemployment escalated to 33.3% in 2020 before the National Bureau of Statistics revised its measurement methodology in 2023, creating a statistical discontinuity in reported jobless figures (National Bureau of Statistics, 2024). Despite fiscal reforms such as the Medium-Term Expenditure Framework, the Treasury Single Account, and subsidy removals (Garba, 2011; IMF, 2012; AfDB, 2025), empirical evidence on the macroeconomic efficacy of deficit financing remains inconclusive. Existing Nigerian studies largely evaluate GDP growth and unemployment in isolation and fail to account for structural regime shifts or debt composition (Akamobi & Unachukwu, 2021; Akpan & Okoloegbo, 2024).

Against this backdrop, this study investigates the long-run effects of budget deficit financing, decomposed into domestic and foreign debt, on GDP and unemployment in Nigeria from 1986 to 2024. Because output growth and unemployment represent fundamentally distinct macroeconomic endpoints, the study estimates two separate cointegrating equations using the Dynamic Ordinary Least Squares (DOLS) framework, while controlling for real exchange rate dynamics. By isolating the individual transmission channels of domestic versus external debt, this study provides actionable empirical evidence to guide sustainable deficit financing and employment generation in Nigeria.

2.0 Literature Review

2.1 Conceptual Clarification

A fundamental conceptual distinction in public finance lies between a budget deficit and budget deficit financing. A budget deficit represents an ex-post flow imbalance, an accounting gap that arises when aggregate public expenditure exceeds fiscal revenue ($G > T$) within a given fiscal period (Mavodyo, 2023). In contrast, budget deficit financing refers to the deliberate liability-management strategies and financial instruments mobilized by fiscal and monetary authorities to bridge this resource gap (Kelvin, 2025; Ngwobia et al., 2025). Conflating the fiscal imbalance itself with its financing mechanisms obscures the specific macroeconomic transmission channels through which alternative funding sources impact the broader economy.

While the magnitude of a budget deficit reflects the scale of a government's fiscal shortfall, its ultimate macroeconomic consequences are governed primarily by the composition of deficit financing. Governments typically rely on domestic government debt (DGD), foreign government debt (FGD), or central bank monetization, each carrying distinct implications for domestic liquidity, capital accumulation, and external debt sustainability (Abdullahi et al., 2025; Righteous et al., 2024).

2.2 Empirical Literature

2.2.1 Deficit Financing and Economic Growth

Empirical evidence on the growth effects of deficit financing is sharply divided, with outcomes contingent on financing composition, expenditure quality, and the time horizon under consideration. A substantial body of international evidence documents growth-retarding effects, particularly in economies with shallow financial markets. Using the ARDL framework, Al-Sawaie et al. (2025) found that persistent deficit financing significantly reduces real GDP in Jordan, while Ouertani and Hamdani (2025) reported similar long-run contractionary effects on per capita growth in Tunisia using OLS and GMM estimators. In South Africa, Mavodyo (2023) established a negative long-run relationship via DOLS, attributing the result to domestic borrowing crowding out private investment in a capital-constrained economy. These findings align with neoclassical predictions that sustained government absorption of loanable funds elevates interest rates and depresses private capital formation (Adedokun et al., 2024).

Conversely, studies that disaggregate the expenditure side of deficit financing reveal positive growth outcomes when borrowed funds target productive infrastructure. Nimpagaritse et al. (2025) demonstrated that in Burundi, despite adverse short-run adjustments, deficit financing stimulated long-run growth by expanding core public capital. Bayat et al. (2023) similarly found positive GDP effects in Iran when deficits were financed through structured debt securities and foreign exchange reserves. Within Nigeria, Kelvin (2025), Muhammad (2024), Boniface et al. (2024), Uremadu et al. (2024), and Akpan and Okoloegbo (2024) all identified significant positive long-run growth elasticities, arguing that deficit-financed infrastructure and human capital investments enhance aggregate supply sufficiently to offset borrowing costs.

Righteous et al. (2024) demonstrated that domestic borrowing positively influenced Nigerian economic growth, whereas excessive reliance on foreign-currency-denominated external debt depressed long-run output through debt-service leakages and exchange rate vulnerability. Uremadu et al. (2024) corroborated this finding, reporting that domestic debt financing significantly enhanced real GDP while external debt remained statistically insignificant. Boniface et al. (2024), however, qualified this by noting that external borrowing can support growth when obtained on concessional terms and allocated to productive sectors, suggesting that the growth impact depends on both borrowing structure and expenditure efficiency.

Sore et al. (2024) found that across Sub-Saharan Africa, fiscal deficits stimulate growth in the short run through Keynesian demand multipliers but generate negative long-run effects once debt thresholds are breached and debt overhang sets in. Nimpagaritse et al. (2025) similarly documented transitory short-run contractionary adjustments preceding long-run expansion in Burundi. These temporal asymmetries

underscore the importance of distinguishing between cyclical stimulus effects and structural debt sustainability when evaluating the growth consequences of deficit financing.

2.2.2 Deficit Financing and Unemployment

Compared to the extensive growth literature, empirical evidence on the unemployment effects of deficit financing remains limited and concentrated in a small number of Nigerian studies. From a Keynesian perspective, deficit-financed public expenditure is expected to reduce unemployment through two channels: direct employment creation via public works and infrastructure projects, and indirect job generation through backward and forward linkages that stimulate private-sector labour demand (Jallow, 2024). Akpan and Okoloegbo (2024) provided empirical support for this mechanism, finding that fiscal deficits significantly reduced unemployment in Nigeria over the long run, particularly when expenditure targeted labour-intensive productive sectors.

The distinction between domestic and external financing, as well as between short-run and long-run horizons, introduces important nuances. Dominic et al. (2025) demonstrated that both domestic and external deficit financing significantly influence unemployment in Nigeria, but the magnitude and direction of these effects diverge across time horizons. In the short run, external borrowing provided immediate liquidity for public works and social programmes, generating temporary employment gains. However, in the long run, escalating debt-servicing obligations on foreign-currency-denominated debt constrained fiscal space, ultimately increasing unemployment as governments curtailed recurrent and capital expenditures to meet external obligations. Domestic borrowing, by contrast, exhibited more sustained employment effects, consistent with the absence of exchange rate and debt-service leakage channels.

Macroeconomic coordination failures further mediate the employment impact of deficit financing. Ngwobia et al. (2025) showed that deficit financing fails to reduce structural unemployment when accompanied by inflationary pressures and exchange rate depreciation, as rising input costs force private firms to retrench workers, neutralizing any public-sector employment gains. This finding highlights that the labour market effectiveness of deficit financing depends not only on the volume and composition of borrowing but also on the broader macroeconomic environment in which fiscal expansion occurs.

Notwithstanding these insights, the empirical literature on deficit financing and unemployment remains underdeveloped relative to the growth literature. Most existing studies treat unemployment as a secondary outcome rather than a primary cointegrating variable, and few explicitly decompose the differential employment effects of domestic versus external debt across short-run and long-run horizons. This gap represents a critical limitation that the present study seeks to address by estimating unemployment as a distinct long-run equilibrium outcome alongside GDP within the DOLS framework.

Gaps in Literature

In spite of the extensive literature, three critical gaps remain. First, empirical studies in Nigeria predominantly evaluate deficit financing against aggregate output or inflation in isolation, largely neglecting unemployment as a parallel long-run cointegrating outcome (Abdullahi et al., 2025; Kelvin,

2025). Second, existing research frequently aggregates fiscal deficits, masking the distinct macroeconomic transmission channels of domestic versus external debt (Righteous et al., 2024). Methodologically, widely used static OLS and standard ARDL models often fail to adequately eliminate small-sample endogeneity and reverse causality inherent in debt–growth dynamics. Furthermore, most studies rely on datasets that predate recent macroeconomic disruptions, including the COVID-19 pandemic and the 2023 fiscal and exchange rate reforms.

This study resolves these deficiencies by examining the disaggregated effects of domestic and foreign debt financing simultaneously on both GDP and unemployment over the extended 1986–2024 horizon. By deploying the Dynamic Ordinary Least Squares (DOLS) estimator, the study explicitly corrects for regressor endogeneity and serial correlation via dynamic lead and lag augmentations, ensuring robust, asymptotically efficient long-run estimates.

2.2 Theoretical Framework

This study is anchored on the Keynesian Theory of Fiscal Policy and Aggregate Demand (Keynes, 1936). While the national income identity decomposes output as $Y = C + I + G + (X - M)$, the causal transmission from deficit financing to output and unemployment operates through an expenditure-multiplier and derived-labour-demand mechanism:

$$\text{Deficit Financing } (D, GDFGD) \rightarrow \Delta G > \Delta T \rightarrow \Delta AD \xrightarrow{\text{Multiplier } (k)} \Delta Y \xrightarrow{\text{Derived Demand}} \nabla UNE$$

Financing deficits via domestic debt (DGD) or external borrowing (FGD) expands autonomous public spending (ΔG) without an immediate contraction in private disposable income. Through the fiscal multiplier ($\Delta Y = k \cdot \Delta G$, where $k = \frac{1}{1-MPC(1-t)+m}$), this autonomous injection raises aggregate demand and real output (Y). In turn, output expansion increases the derived demand for labour (Okun's law mechanism), thereby contracting unemployment (UNE) (Jallow, 2024). This mechanism assumes that the economy possesses idle productive capacity, prices exhibit short-run rigidity, and borrowed funds finance productive capital formation.

Conversely, the Neoclassical Crowding-Out Hypothesis cautions that domestic debt financing (DGD) intensifies competition in loanable funds markets, raising interest rates and displacing private investment ($I \downarrow$), which impairs long-term growth and employment (Adedokun, Adeniyi, & Olaniyi, 2024). Furthermore, the Ricardian Equivalence Hypothesis posits that forward-looking households anticipate future tax liabilities, offsetting fiscal stimulus through increased private savings ($k \rightarrow 0$) (Mavodyo, 2023). This integrated framework establishes competing, testable hypotheses regarding the net macroeconomic impacts of deficit financing in Nigeria..

3.0 Methodology

This study adopts an ex post facto research design to examine the impact of government budget deficit financing on GDP growth and unemployment in Nigeria over the period 1986–2024. Following the theoretical framework and previous empirical study by Akpan and Okoloegbo (2024), government budget

deficit financing is proxied by domestic government debt (DGD) and foreign government debt (FGD), while the real exchange rate (EXR) is included as a control variable. The functional models are specified as:

$$\text{Model I: } RGDP = f(DGD, FGD, EXR) \quad 1$$

$$\text{Model II: } UNE = f(DGD, FGD, EXR) \quad 2$$

The corresponding econometric models are expressed as:

Model I (GDP Growth Equation)

$$RGDP_t = \beta_0 + \beta_1 DGD_t + \beta_2 FGD_t + \beta_3 EXR_t + \mu_t \quad 3$$

Model II (Unemployment Equation)

$$UNE_t = \alpha_0 + \alpha_1 DGD_t + \alpha_2 FGD_t + \alpha_3 EXR_t + \varepsilon_t \quad 4$$

where RGDP is the real GDP growth rate, UNE is the unemployment rate, DGD represents domestic government debt, FGD denotes foreign government debt, EXR is the real exchange rate, while μ_t and ε_t are stochastic error terms.

To estimate the long-run relationships, the study employs the Dynamic Ordinary Least Squares (DOLS) estimator developed by Stock and Watson (1993). DOLS is preferred because it produces consistent and efficient estimates for cointegrated variables by correcting for endogeneity and serial correlation through the inclusion of leads and lags of the first-differenced explanatory variables. The general DOLS model is specified as:

$$Y_t = \beta_0 + \sum_{i=1}^k \beta_i X_{it} + \sum_{j=-q}^q \gamma_j \Delta X_{t-j} + \mu_t \quad 5$$

where Y_t is the dependent variable, X_{it} represents the explanatory variables, ΔX_{t-j} denotes the leads and lags of the first-differenced regressors, β_i are the long-run coefficients, and γ_j captures the short-run dynamic adjustments.

The Dynamic Ordinary Least Squares (DOLS) technique, including one lead and one lag of the first-differenced explanatory variables (i.e., $q = 1$) is specified below.

Model 1: RGDP Growth Equation (DOLS Form)

$$RGDP_t = \beta_0 + \beta_1 DGD_t + \beta_2 FGD_t + \beta_3 EXR_t + \gamma_1 \Delta DGD_{t-1} + \gamma_2 \Delta DGD_{t+1} + \gamma_3 \Delta FGD_{t-1} + \gamma_4 \Delta FGD_{t+1} + \gamma_5 \Delta EXR_{t-1} + \gamma_6 \Delta EXR_{t+1} + \mu_{1t} \quad 6$$

Model 2: Unemployment Equation (DOLS Form)

$$UNE_t = \alpha_0 + \alpha_1 DGD_t + \alpha_2 FGD_t + \alpha_3 EXR_t + \delta_1 \Delta DGD_{t-1} + \delta_2 \Delta DGD_{t+1} + \delta_3 \Delta FGD_{t-1} + \delta_4 \Delta FGD_{t+1} + \delta_5 \Delta EXR_{t-1} + \delta_6 \Delta EXR_{t+1} + \mu_{2t} \quad 7$$

Where: Δ = first difference operator; $t - 1$ and $t + 1$ denote one lag and one lead, respectively; γ_i and δ_i represent short-run dynamic adjustment coefficients; μ_{1t} and μ_{2t} are stochastic error terms

The inclusion of one lead and one lag ($q = 1$) helps to correct for endogeneity and serial correlation, thereby ensuring unbiased and consistent estimation of the long-run coefficients.

The study utilizes annual secondary data covering the period 1986–2024, obtained from the Central Bank of Nigeria (CBN) Statistical Bulletin and the World Bank's World Development Indicators (WDI). Real GDP growth rate and unemployment rate constitute the dependent variables, while domestic debt and foreign debt serve as proxies for government budget deficit financing. The exchange rate is incorporated as a control variable to account for prevailing macroeconomic conditions.

Prior to estimation, the stationarity properties of the series are examined using the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests, followed by the Engle-Granger cointegration test to establish the existence of a long-run equilibrium relationship among the variables. To ensure the robustness of the estimated models, diagnostic tests were conducted.

4.0 Results and Discussion

Table 1: ADF and PP Unit Root Test Results

ADF Unit Root Result					
Variables	At Level		At First Difference		Order of integration
	T – statistics	P-value	T – statistics	P-value	
RGDP	-2.6135	0.2777	-10.3672	0.0000	I(1)
UNE	-0.6127	0.4449	-3.2758	0.0267	I(1)
DGD	-1.5209	0.5121	-4.9029	0.0003	I(1)
FGD	-1.3570	0.5928	-4.9235	0.0003	I(1)
EXR	-0.6127	0.4449	-7.1955	0.0000	I(1)
PP Unit Root Result					
Variables	At Level		At First Difference		Order of integration
	T – statistics	P-value	T – statistics	P-value	
RGDP	0.2524	0.7540	-18.3959	0.0001	I(1)
UNE	-0.9014	0.7763	-3.0727	0.0383	I(1)
DGD	-0.8868	0.7816	-4.9118	0.0003	I(1)
FGD	-1.6411	0.4523	-4.9243	0.0003	I(1)
EXR	-0.8683	0.3333	-7.4958	0.0000	I(1)

Source: Author's computations from EViews (2026)

Table 1 shows that both the ADF and PP test statistics show that all variables (*RGDP*, *UNE*, *DGD*, *FGD*, *EXR*) are non-stationary at levels ($p > 0.05$) but reject the unit-root null hypothesis at first difference ($p < 0.05$). Establishing that all series are strictly integrated of order one, $I(1)$, satisfies the requisite condition for Engle–Granger cointegration testing and subsequent DOLS estimation..

Table 2: Engle–Granger Cointegration Test Results (Residual-Based ADF Test)

Model	ADF t-Statistic	5% Critical Value	Order of Integration	Prob.	Decision
RGDP Equation	-5.141763	-1.949856	1(0)	0.0000	Cointegrated
Unemployment Equation	-2.241246	-1.952473	1(0)	0.0263	Cointegrated

Source: Author's computations from Eviews (2026)

As shown in Table 2 the residual-based ADF statistics reject the null hypothesis of no cointegration ($p < 0.05$) for both the RGDP ($t = -5.142$) and unemployment ($t = -2.241$) models. The resulting stationary residuals, $I(0)$, confirm valid long-run equilibrium relationships linking deficit financing mechanisms to both macroeconomic indicators, justifying estimation via Dynamic Ordinary Least Squares (DOLS).

Table 3: DOLS Estimation Results for RGDP

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Remark
DGD	81.57809	38.26927	2.131686	0.0439	Significant
FGD	-43.01957	15.26809	-2.817613	0.0079	Significant
EXR	-0.021779	0.033225	-0.655508	0.5186	Not Significant
C	13.08082	3.337439	3.919419	0.0007	Significant
R-squared	0.880484				
Adjusted R-squared	0.609432				

Source: Author's computations from Eviews (2026)

Table 3 show that domestic government debt (DGD) has a positive and statistically significant effect on RGDP, with a coefficient of 81.58, implying that a 1% increase in domestic debt increases RGDP by approximately 81.58%, *ceteris paribus*. This suggests that domestic borrowing, when channelled into productive investments, stimulates economic growth by enhancing aggregate demand and public investment. The finding supports the Keynesian proposition and is consistent with Akpan and Okoloegbo (2024) and Nimpagaritse et al. (2025).

Foreign government debt (FGD) exerts a negative and significant effect on RGDP, with a coefficient of -43.02, indicating that a 1% increase in external debt reduces RGDP by about 43.02%. This suggests that excessive reliance on foreign borrowing may constrain growth through rising debt-servicing obligations and reduced productive investment. The result corroborates the findings of Mavodyo (2023) and Uguru and Williams (2025).

The exchange rate (EXR) has a negative but statistically insignificant coefficient (-0.0218; $p = 0.5186$), indicating that exchange rate movements do not significantly influence RGDP over the study period. This implies that economic growth in Nigeria is more responsive to fiscal financing than exchange rate fluctuations, consistent with Kelvin (2025).

The model exhibits strong explanatory power, with an R^2 of 0.88, indicating that approximately 88% of the variation in RGDP is explained by domestic debt, foreign debt, and exchange rate. This suggests that the estimated model provides a good fit and adequately captures the long-run determinants of economic growth in Nigeria.

Table 4: DOLS Estimation Results for UNE

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Remark
DGD	-3.418755	1.401923	-2.438618	0.0200	Significant
FGD	4.217134	1.483587	2.842525	0.0075	Significant
EXR	0.603306	0.161964	3.724945	0.0007	Significant
C	2.927384	1.118707	2.616755	0.0157	Significant
R-squared	0.800896				
Adjusted R-squared	0.783203				

Source: Author's computations from Eviews (2026)

Table 4 show that domestic government debt (DGD) has a negative and statistically significant effect on unemployment, with a coefficient of -3.42 ($p = 0.020$), implying that a 1% increase in domestic debt reduces unemployment by approximately 3.42%, *ceteris paribus*. This suggests that domestic borrowing supports job creation by financing productive public investments and infrastructure projects. The finding

is consistent with Keynesian theory and the empirical evidence of Akpan and Okoloegbo (2024) and Dominic et al. (2025).

Foreign government debt (FGD) has a positive and statistically significant coefficient of 4.22 ($p = 0.0075$), indicating that a 1% increase in external debt raises unemployment by about 4.22%. This suggests that excessive dependence on foreign borrowing may weaken labour market performance through rising debt-servicing burdens and reduced productive investment. The result supports the findings of Mavodyo (2023) and Uguru and Williams (2025).

The exchange rate (EXR) has a positive and statistically significant coefficient of 0.603 ($p = 0.0007$), indicating that exchange rate appreciation is associated with an increase in unemployment. This implies that exchange rate movements significantly influence labour market outcomes, possibly by reducing export competitiveness and economic activity.

The model demonstrates good explanatory power, with an R^2 of 0.80 and an adjusted R^2 of 0.78, indicating that approximately 80% of the variation in unemployment is explained by domestic debt, foreign debt, and exchange rate. This suggests that government budget deficit financing plays a significant role in shaping unemployment outcomes in Nigeria.

Table 5: Summary of Diagnostic Results

Test	Model one: RGDP	Model one: UNE
	Prob	Prob
Normality	0.242277	0.4458
Serial Correlation	0.3118	0.2396
Heteroskedasticity Test	0.6756	0.6170
Ramsey RESET	0.0528	0.9331

Source: Author's computations from EViews (2026)

The post-estimation diagnostic tests for both models indicate that the regression results are reliable and robust. For Model One (GDP growth) and Model Two (Unemployment), the residuals pass the normality test, with p-values of 0.2423 and 0.4458, respectively, suggesting that the error terms are normally distributed. The Breusch-Godfrey tests for serial correlation yield p-values of 0.3118 for GDP and 0.2396 for unemployment, indicating no significant autocorrelation in the residuals. Similarly, the Breusch-Pagan heteroskedasticity tests yield p-values of 0.6756 and 0.6170, confirming that the residuals are homoskedastic and constant in variance across both models. The Ramsey RESET test results also suggest proper model specification, with the GDP model slightly below conventional significance ($p = 0.0528$) but still broadly acceptable, and the unemployment model clearly well-specified ($p = 0.9331$).

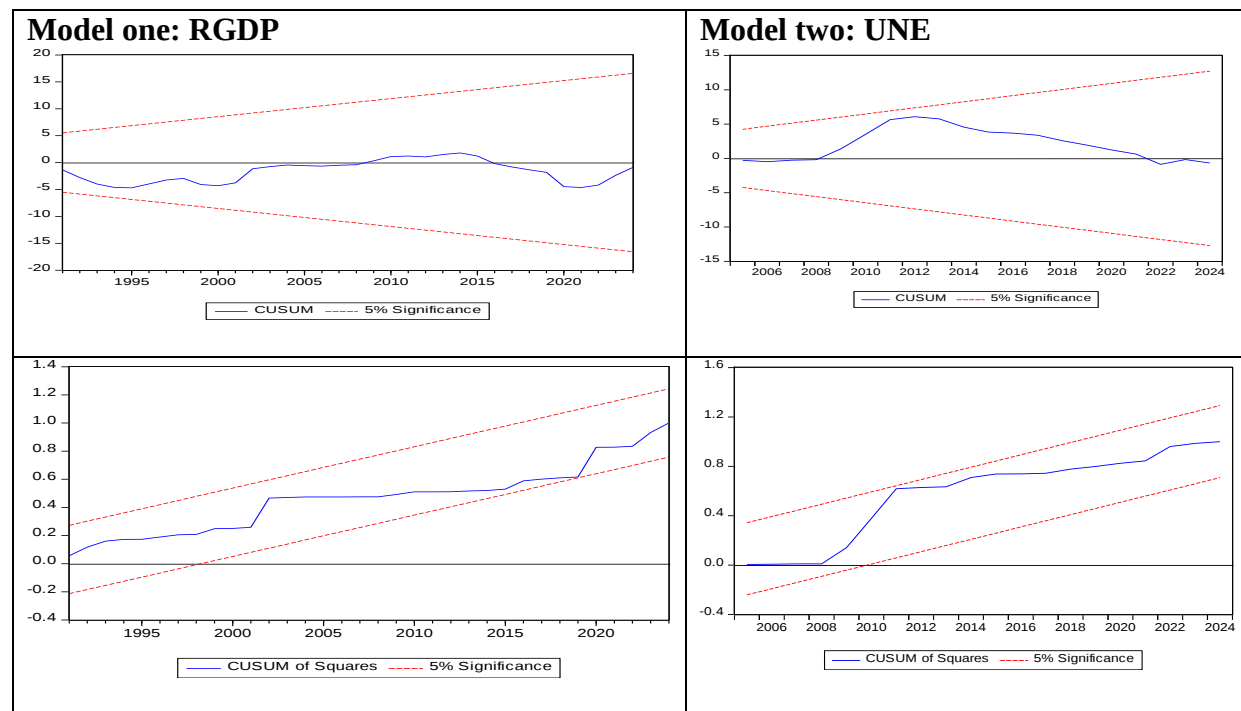


Figure 1: CUSUM and CUSUM of Squares

Source: Author's computations from EViews (2026)

Additionally, both the CUSUM and CUSUM of squares tests indicate that the Wald statistic falls within the critical bounds for the entire sample period. This demonstrates that the coefficients in both models are stable over time and that no structural breaks are affecting the long-run relationships.

Discussion and Implications of Findings

The findings demonstrate that government budget deficit financing exerts differing effects on Nigeria's macroeconomic performance depending on the source of financing. Domestic government debt (DGD) has a positive and significant impact on GDP growth, whereas foreign government debt (FGD) exerts a significant negative effect. These results support the Keynesian view that deficit-financed public expenditure can stimulate aggregate demand and economic growth when financed domestically and directed toward productive investments. In contrast, the adverse effect of foreign debt supports the neoclassical crowding-out hypothesis, which argues that excessive external borrowing may increase debt-servicing obligations, discourage private investment, and weaken long-run economic performance. The findings are consistent with Kelvin (2025) and Nwandu and Ubochi-Nwankwo (2024), who similarly reported that domestic borrowing promotes growth, while poorly managed external debt constrains economic expansion.

The unemployment model provides complementary evidence. Domestic government debt significantly reduces unemployment, indicating that domestic deficit financing contributes to job creation by supporting infrastructure development, public investment, and other employment-generating activities. Conversely, foreign government debt significantly increases unemployment, suggesting that excessive dependence on external borrowing may divert resources toward debt servicing rather than productive investment capable of generating employment. Furthermore, the positive and significant effect of the exchange rate on unemployment indicates that exchange rate instability adversely affects labour market performance by

increasing production costs and weakening economic activity. These findings corroborate those of Dominic et al. (2025) and Akpan and Okoloegbo (2024), who found that productive domestic borrowing enhances employment, whereas external debt may have adverse labour market consequences.

The results have important policy implications for fiscal management in Nigeria. First, they suggest that domestic borrowing should remain the preferred source of financing fiscal deficits, provided that borrowed funds are invested in productive sectors capable of stimulating economic growth and employment. Second, the negative effects of foreign debt highlight the need for prudent external borrowing, improved debt management, and greater accountability in the utilization of borrowed funds to ensure that external financing translates into productive investments with long-term economic benefits. Finally, the significant influence of exchange rate movements on unemployment underscores the importance of maintaining macroeconomic stability through sound exchange rate and fiscal policies.

The findings suggest that the effectiveness of government budget deficit financing depends not only on the size of the deficit but also on the composition and management of its financing sources. While domestic borrowing appears to support inclusive growth and employment creation, excessive reliance on foreign debt may undermine these objectives. Consequently, fiscal authorities should prioritize sustainable domestic financing strategies while exercising caution in the accumulation and utilization of external debt to promote long-term economic growth and labour market stability in Nigeria.

5.0 Conclusion and Recommendations

This study examined the impact of government budget deficit financing on GDP growth and unemployment in Nigeria using the Dynamic Ordinary Least Squares (DOLS) technique. The findings indicate that domestic government debt significantly promotes economic growth and reduces unemployment, suggesting that internally financed deficit spending can stimulate aggregate demand, investment, and job creation. In contrast, foreign government debt exerts a significant negative effect on GDP growth while increasing unemployment, implying that excessive reliance on external borrowing may undermine long-term macroeconomic performance through rising debt-servicing obligations and reduced productive investment. The results also show that exchange rate movements significantly influence unemployment, highlighting the importance of maintaining macroeconomic stability. Overall, the study concludes that the effectiveness of budget deficit financing depends largely on its financing structure and the productive utilization of borrowed funds.

Based on these findings, the study recommends that;

- i. The Nigerian government should prioritize domestic borrowing over external debt in financing fiscal deficits while ensuring that borrowed funds are invested in productive sectors such as infrastructure, agriculture, manufacturing, and human capital development to promote sustainable growth and employment.
- ii. In addition, external borrowing should be undertaken prudently, with strict monitoring and accountability mechanisms to ensure efficient utilization and debt sustainability.

This study contributes to the literature by providing empirical evidence on the distinct effects of domestic and foreign government debt on GDP growth and unemployment in Nigeria. Using the Dynamic Ordinary Least Squares (DOLS) technique, it offers robust long-run estimates while addressing endogeneity and non-stationarity issues. The inclusion of exchange rate as a control variable further enriches the analysis by capturing external macroeconomic influences. The findings provide valuable policy insights,

emphasizing the importance of prioritizing domestic borrowing and prudently managing external debt to achieve sustainable growth and employment.

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