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INFLATION'S IMPACT ON GOVERNMENT SPENDING IN THE NIGERIAN ECONOMY (1981-2019)

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MAZEDAN INTERNATIONAL BUSINESS REVIEW
e-ISSN: 2583-0929
Article id-MIBR0204002
Vol-2, Issue-4
Received: 28 Sep 2021
Revised: 8 Nov 2021
Accepted: 10 Nov 2021

Citation: Danladi, G. P., (2021). Inflation's Impact on Government Spending in the Nigerian Economy (1981-2019). *Mazedan International Business Review*, 2(4), 20-25.

Abstract

Inflation is an unavoidable part of every economy. It has an impact on every country, whether developed and developing, both badly and positively. From 1981 to 2019, this research looked at the influence of inflation on government expenditure in the Nigerian economy. Ex-post-facto research design was used in this study. In this study, secondary data from the Central Bank of Nigeria's statistics Bulletin of 2020 is analyzed using the Ordinary Least Square (OLS) regression approach. The statistical program E-view version 10 was utilized. Inflation has an inverse and considerable influence on public expenditure in the economy, according to the findings. It also demonstrates that inflation and government expenditure have a bidirectional causal relationship. To successfully control the money supply in the economy, the research advised the establishment of an adequate fiscal and monetary policy combination. Among the proposals given were to redirect government expenditure to productive sectors of the economy in order to enhance the supply of products and services compared to demand, hence minimizing rising inflationary pressures and transforming the economy to production-based.

Keywords: inflation, money supply, Ordinary Least Square, government spending's

1. INTRODUCTION

Inflation is an issue in every aspect of life and in every economic entity, whether developed or emerging. Any nation's government is concerned with the obligation of ensuring that its goals and programs are not thwarted by volatile and rapidly rising prices. Every company wants a stable macroeconomic environment free of unrelenting pricing changes that allows for accurate forecasting and planning. An individual also seeks to avoid being harmed by unanticipated price increases. (Egbulonu & Wobilor, 2016). Inflation is a major contributor to social and economic instability and chaos, according to the report. Both conceptually and experimentally, it is one of the most often observed and tested economic variables. Its sources, effects on other economic variables, and overall economic cost are all well-known and recognized. Nigeria, as a developing country, has been unable to resist inflation's year-on-year rise and its implications (George-Anokwuru, & Ekpenyong, 2020).

In late 1993, Nigeria's inflation rate began to rise after maintaining relatively low for a long period. Inflation has already reached double digits, which is quite concerning. In Nigeria, the influence of money supply appears to be substantial in affecting food price inflation (George-Anokwuru, & Ekpenyong, 2020), disrupting family budgets and consumer purchasing power. Many writers have written about the effects of inflation and cost of living on the Nigerian economy, but their perspectives range. One thing they all agree on is that inflation and cost of living have distinct effects on the Nigerian economy. The government has found it impossible to handle the problem of growing costs of products and services, which has resulted in a greater cost of living. Fixed sums of money buy less goods and services during an inflationary period. The real worth of money is significantly lowered, lowering consumer purchasing power (Makwandi, & Raphael, 2018).

The link between government spending, sometimes known as government expenditure, and inflation has sparked a number of academic arguments. The remedy to economic depression, according to Keynes (1936), is to encourage enterprises to invest through a mix of interest rate reductions and government capital expenditure, particularly infrastructure. Many academics disagree with his argument that greater government spending fosters economic progress. Several famous scholars, particularly from the Neo-classical school, claim that increasing government spending will reduce the economy's overall performance because, In order to keep up with increased spending, the government may have to raise taxes or borrow more money. Higher income taxes may discourage or disincentivize extra employment, resulting in lower income and aggregate demand. Similarly, a high corporation tax raises production costs and diminishes business profitability and money available for investment. Increased government borrowing (from banks) to fund its expenditures, on the other hand, may compete with and push out the private sector, reducing private investment in the economy.

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Makwandi and Raphael (2018) suggest that, among industrialized nations, those with high inflation tend to spend more on social welfare and do better on most economic indicators than those with low inflation rates. Several studies have been conducted on this topic, including those by Egbulonu and Wobilor in 2016, Makwandi and Raphael in 2018, Oyerinde in 2019, and George-Anokwuru and Ekpenyong in 2020. However, a study of existing empirical literature finds a lack of agreement in previous research findings, indicating the presence of a research gap. As a result, the influence of inflation on government expenditure in the Nigerian economy was investigated in this study.

2. THEORETICAL REVIEW

Some of the theories of public expenditure and inflation mentioned here include the Keynesian versus Classical approach to public spending, Peacock and Wiseman Approach to Government Spending, Inflationary demand-pull theory, and Inflationary Theory of the Monetarists

The Keynesian vs. Classical Approach to Public Expenditure

Classical economics think that government interference harms an economy more than it helps it, and that most activities should be carried out by the private sector. Adam Smith (1776) promotes a "laissez-faire" economy in which the profit motive is the primary driver of economic progress in his Wealth of Nations. According to the classical dichotomy, a rise in the overall amount of money causes a commensurate increase in all money prices, with no change in resource allocation or real GDP, resulting in money neutrality. Classical economists assumed that the economy was perfect: it was always at full employment, wage rates and interest rates were self-adjusting, and the budget should always balance because savings equaled investment. Their goal was definitely not growth because they believed the economy was always at full employment. Classical economists who resisted government action after the Great Depression of 1929-1930 contended that strong trade unions impeded wage flexibility, resulting in high unemployment. On the other hand, the Keynesians advocated for government intervention to fix market failures. In his 1936 book "General Theory of Employment, Interest, and Money," John Maynard Keynes (1883-1946) attacked traditional economists for putting too much focus on the long term. "In the long run, we are all dead," said Keynes. As a short-term treatment, Keynes argued that government action was required during the depression era. "Increasing savings will not help," he believes, "but spending will." As a result, the government will raise public expenditure, increasing people's purchasing power, and manufacturers will create more, resulting in more jobs. This is the multiplier effect, which illustrates that there is a causal link between public spending and national revenue (Omodero, 2019).

Government expenditure, rather than being an endogenous phenomenon, was defined by Keynes as an external ingredient that may boost economic growth. Since a result, Keynes considered the government's involvement to be critical, as it can prevent depression by raising aggregate demand and, as a result, reactivating the economy through the multiplier effect. It is a weapon that provides stability in the near term, but it must be used with caution since too much public spending leads to inflation, while too little leads to unemployment. Keynes (1936) and his followers, on the other hand, argue that the employment of fiscal measures, such as expansionary fiscal policies, increased public expenditures, and so on, improves economic activity during recessions. While Wagner's method implies that causation flows from community output to public expenditure in times of recession, the Keynesian approach thinks that causality runs from public expenditure to community output growth in times of recession.

The Peacock and Wiseman Approach to Government Spending

Based on their analysis of public expenditure in England, Peacock and Wiseman elicited a significant shaft of light regarding the nature of the increase in public expenditure in 1961. According to Peacock and Wiseman (1967), the expansion in government spending does not proceed in the way Wagner predicted. Peacock and Wiseman favor political ideas to the organic state, in which the government likes spending money, voters loathe tax hikes, and the population votes for ever-increasing social benefits. There may be disagreements regarding ideal public expenditure and taxation boundaries, but these can be lowered by large-scale disruptions, such as war.

These disruptions, according to Peacock and Wiseman, will generate a displacement effect, pushing public revenue and spending to new levels. There will be a revenue shortfall for the government, resulting in a tax increase. Citizens will initially be dissatisfied, but in times of catastrophe, they will accept the judgment. There will be a new "tax tolerance" threshold. Individuals are now willing to tolerate increased taxes amounts that were formerly considered unbearable. Furthermore, the public expects the government to repair the economy and adapt to new social concepts, or else the inspection effect will occur. The time of displacement, according to Peacock and Wiseman, reduced impediments to local autonomy while enhancing the Central government's concentrating authority over public spending. The role of state activities tends to get more and larger as the process of centralizing public expenditures progresses. This is referred to as the process of growing public sector activity concentration (Omodero, 2019).

Inflationary demand-pull theory

John Maynard Keynes (1936) proposed this hypothesis in his book "The General Theory of Employment, Interest, and Money." A boost in consumption and investment in both the public and private sectors, according to the Keynesian school, raises aggregate demand. Because aggregate supply is inelastic in the near run, an increase in aggregate demand leads to higher prices. In terms of aggregate supply, if the government borrows more to pay its public expenditure by issuing a bond, interest rates will rise, decreasing private consumption and investment, and so production. The crowding-out effect may completely or partially cancel out any expansionary effects of government expenditure on the economy. If the crowding-out effect is big enough, the government expenditure multiplier can even be negative, implying that an increase in government spending results in a decrease in GDP.

Money creation is another option for the government to support its spending, in addition to acquiring debt (Idenyi, Favour, Johnson, & Thomas, 2017). As the central bank expands its monetary base, the aggregate money supply expands, resulting in more credit supply and, eventually, higher inflation, which leads to increased demand for money and a new equilibrium (Oyerinde, 2019).

Inflationary Theory of the Monetarists

The link between deficits and inflation, according to monetarists, is fundamentally based on the old classical exchange equation (quantity theory). Changes in the quantity of money were supposed to cause corresponding changes in the price level in their pure form. The stance of monetarists on the causation between deficits and inflation may be shown from here. Government deficits are inflationary if they are funded by the production of new money. In short, monetarists believe that bigger deficits lead to higher inflation (Oyerinde, 2019). Monetization of government debt increases money supply and, as a result, inflation. The inflationary effect of deficits, according to this viewpoint, might be prevented if the monetary authorities refused to monetize government loans. They frequently regard monetary accommodation as an act of irresponsibility caused by the monetary authorities' inexperience and shortsightedness (Oyerinde, 2019).

3. REVIEW OF EMPIRICAL LITERATURES

Makwandi and Raphael (2018) investigate the influence of government spending, money supply, and inflation on Tanzanian economic development. One of the primary objectives of macroeconomic policy in Tanzania, like in other developed and developing nations, is to stimulate economic growth and keep the overall price level low. The majority of scholars have taken sides in the long-running dispute over whether inflation helps or hurts economic development. In response to this disagreement, the researchers undertook a study that spanned the years 1970 to 2011. The existence of cointegration was evaluated using an ARDL bounds tests. To evaluate the influence of government spending, money supply, inflation, and their link to Tanzania's economic development, the ARDL model was used. The findings indicate that inflation has a negative influence on economic growth, and that government spending and money supply have a considerable impact on economic growth in both the short and long run, but the magnitudes differ. The report recommends that the government maintain single-digit inflation of less than 3% to prevent harming economic growth and that monetary and fiscal policy be implemented with caution because inflation appears to be an important macroeconomic variable in the economy. In addition, the study advises future researchers to include or exclude additional variables (s) in the model, such as government spending or money supply, in order to examine the impact of inflation on economic growth.

From 1970 to 2010, Olayungbo (2013) investigates the asymmetric causal link between government expenditure and inflation in Nigeria. In the VAR2 model, the asymmetric causality test reveals that negative government expenditure changes (low or contractionary government spending) lead to positive inflation changes (high inflation). The findings suggest that Nigeria's inflationary pressure is state-dependent, implying that high inflation is driven by low or contractionary government expenditure. Aiyedogbon (2012) looked at the link between inflation and macroeconomic factors such as military spending, the currency rate, and economic growth as measured by gross domestic product and gross fixed capital formation. For a data set spanning 1980 to 2010, the study uses a vector error correction model and granger causality techniques. The conclusions are consistent with those of previous research, namely that military spending does not cause inflation in Nigeria, and so it is advised that the military sector's existing financing be maintained for effective combat preparation both internally and abroad.

In a similar development, George-Anokwuru, & Ekpenyong, (2020) looked at the influence of government expenditure on Nigerian inflation levels from 1999 to 2019. The study's data came from the CBN statistics bulletin, and the major analytical technique was the Autoregressive Distributed Lag model. Using the ARDL Bounds test, a long-run link between the variables in this research was discovered. In the short run, the study likewise demonstrated a positive but negligible link between government spending and inflation rate. Furthermore, government spending has a negative long-term inflation rate that is statistically significant. In the near term, money supply has a negative correlation with inflation and is statistically negligible. In the long run, the money supply and inflation rate have a positive and substantial connection. In both the short and long term, the gross domestic product was adversely connected to the inflation rate. Furthermore, the exchange rate had a negative and large impact on inflation in the near term, as well as a positive and major impact in the long run. In both the short and long run, rising population needs had a positive and considerable impact on inflation rates. In the short term, the investment was favorably associated to inflation, but the association was not significant; nevertheless, in the long run, the relationship was negative and substantial. As a result, the research advised, among other things, that the government use discretion in spending in order to keep inflation under control. This can be accomplished by directing expenditure toward productive activities that will mitigate rather than worsen the effects of inflation. Only a few studies looked at the impact of government expenditure on inflation in nations, according to the literature assessment. The results of these research, however, were mixed.

4. METHODOLOGY

Ex-post-facto research design was used in this study. The influence of inflation on government expenditure in Nigeria was studied using annual time series secondary data from 1981 to 2019. The research spanned the years 1981 to 2019, a period of 38 years thought to be long enough to account for the long-term link between the datasets in Nigeria. In this study, secondary data from the Central Bank of Nigeria's statistics Bulletin of 2020 is analyzed using the Ordinary Least Square (OLS) regression approach. The statistical program E-view version 10 was utilized. Statistics that are descriptive in nature, to analyze the data's stationarity, the enhanced Dickey-Fuller unit root test approach was applied. The long-run connection between the variables was tested using Johansson Co-integration. The Granger causality

test was performed to determine the causal relationship between the variables.

Specifications for the Model

This study's model specification is based on Dikeogu's (2018) work on the influence of government expenditure on inflation in Nigeria from 1980 to 2017, with some modifications. The previous analysis used public capital and recurrent spending, but this study utilized total government expenditure, money supply, and inflation interest rates from 1981 to 2019. As a result, the model is defined as:

INF = F (GEXP, MS, INT) (1)

This functional relationship can be expanded below-

$$INF = \beta_0 + \beta_1 GEXP + \beta_2 MS + \beta_3 INT + \mu i \quad (2)$$

Thus, a priori expectations are b0, b1, b2, & b3 = >0

Where:

INF-represented the inflation rate

GEXP represented the government expenditure

MS represented the money supply

INT represented the interest rate

b_0 represented the constant intercept

b_1, b_2, b_3 represented the slopes of the regressions

U represented the error term

Presentation of the findings

Table 1 Descriptive Statistics

Parameters	GEXP	INF	MS	INT
Mean	22478212	29.98286	8451842.	13.28571
Median	487113.4	13.00000	488145.8	13.00000
Maximum	3.51E+08	72.80000	1.87E+08	26.00000
Minimum	9636.500	5.400000	14471.17	6.130000
Std. Dev.	69433145	26.94160	31430570	3.782611
Skewness	6.517192	2.601129	5.439957	1.005607
Kurtosis	31.90565	4.679052	31.38495	5.113161
Jarque-Bera	1396.054	19.06577	1347.614	12.41104
Probability	0.000000	0.000072	0.000000	0.002018
Sum	4.37E+08	699.4000	2.96E+08	465.0000
Sum Sq. Dev.	2.20E+17	8758.610	3.36E+16	486.4771
Observations	38	38	38	38

Computation of the Author, 2021 (Eview-10)

Because the variables' kurtosis values are more than three, the descriptive statistics in Table 1 imply that they are leptokurtic. This suggests a distribution that is flatter than average. The Kurtosis test, in particular, demonstrates that the variables have big tails. All of the series have positive Skewness test results, indicating that they had large tails. Jarque-Bera statistics show that the variables have a normal distribution based on their likelihood.

Unit Root Test

The Augmented Dickey-Fuller (ADF) test was employed to determine if the four variables in the research display unit root property, as in previous studies. This will determine whether or not the link between economic factors is fictitious or illogical.

Table 2 Summary of Unit Root Test Results

Variables	ADF Test Statistic (at first difference)	Order of Integration
INF	-6.560783(-3.954021)	*I(0)*
GEXP	-7.300622(-3.976263)	*I(0)*
MS	-6.848384(-4.986225)	*I(0)*
INT	-9.276958(-1.957110)	*I(0)*

Computation of the Author, 2021 (Eview-10)

Computation of the Author, 2021 (Eview-10)

All of the variable's INF, GEXP, MS, and INT included in the model were determined to be stationary at level 1(0) according to table 2. As a result, OLS is the optimal regression method to use. The co-integration test of these variables is the next test to be computed.

Table 3 Co-integration Estimate

Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.607799	80.29992	63.87610	0.0011
At most 1 *	0.639274	59.41255	32.91525	0.0099
At most 2	0.768558	13.83912	15.87211	0.0177
At most 3	0.830988	6.667425	2.51798	0.2019
Hypothesized		Max-Eigen	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None	0.507799	20.88737	22.11832	0.0401
At most 1	0.439274	15.57343	15.82321	0.0539
At most 2	0.468558	25.17170	18.38704	0.1845
At most 3	0.630988	7.667425	11.51798	0.0019

Computation of the Author, 2021 (Eview-10)

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The trace test suggests two cointegrating equations at a 5% level, based on the co-integrated result in table 3. Furthermore, the Max-eigenvalue test verifies the existence of two cointegrating equations at the 5% level. As a result, the model demonstrates that the four variables studied have a long-run equilibrium connection. It demonstrates that in the long term, the variables converge.

To obtain the numerical estimates of the coefficients of the model, the estimation of the model requires the use of various econometric methods, their assumptions, and the economic implications of the estimates of the parameters.

Table 4 Estimated Regression Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-3.605508	11.91079	-0.338801	0.7129
GEXP	-5.65009	6.85E-08	-4.075209	0.0004
MS	-8.69008	11.13E-08	-0.304747	0.5885
INT	2.729196	0.870183	3.245175	0.0223
R-squared	0.962423	Mean dependent var		20.10000
Adjusted R-squared	0.928665	S.D. dependent var		17.18198
S.E. of regression	16.49233	Akaike info criterion		8.553799
Sum squared resid	8159.913	Schwarz criterion		8.733371
Log-likelihood	-141.4146	Hannan-Quinn criteria.		8.615039
F-statistic	19.139195	Durbin-Watson stat		1.514320
Prob(F-statistic)	0.000535			

Computation of the Author, 2021 (Eview-10)

$$INF = -3.61 - 5.65GEXP - 8.69MS + 2.73INT + \mu i \quad (3)$$

Inflation has a negative and large influence on government spending in Nigeria, according to table 4 and model 3. In Nigeria, inflation has a negative but minor influence on the money supply. In Nigeria, however, inflation has a positive and large influence on interest rates.

The coefficient of determination (R-square), which is used to determine the estimated model's goodness of fit, indicates that the model is reasonably fit in prediction, i.e., GEXP, MS, and INT together accounted for 96.24 percent of the change in INF, while the white noise error term captured 3.76 percent of the unaccounted variations. It showed that GEX, MS, and INT had a strong significant impact on the growth of the Nigerian economy. It was discovered that GEX, MS, and INT had a major influence on the Nigerian economy's growth. The F-statistic is used to assess the overall significance of a regression model that includes all K variables. As a result, by assessing the model's overall fit and significance, it can be shown that the model has a superior fit. The likelihood F-statistic value of 0.005350, in other words, is less than 0.05. Durbin Watson's (DW) statistic was also employed to see if the error terms had any serial correlation or autocorrelation.

The alternative hypothesis (H1) is also accepted, as the Durbin Watson (DW) statistic of 1.51 indicates that the variables have no autocorrelation. The model may be used to make policy choices since it provides an impartial estimate.

Table 5 Pairwise Granger Causality Tests

Null Hypothesis:	Obs	F-Statistic	Prob.
INF does not Granger Cause GEXP	38	4.11732	0.0087
GEXP does not Granger Cause INF		5.89978	0.0071

Computation of the Author, 2021 (Eview-10)

Table 5 shows that in Nigeria, there is a bidirectional connection between inflation and government spending. Government expenditure changes as a result of inflation, and inflation changes as a result of government spending.

Post-Estimation Diagnostics Tests

The LM test of serial correlation

Furthermore, based on the results of the serial LM test, the regression model is devoid of serial correlation.

Table 6 Breusch-Godfrey Serial Correlation LM Test

F-statistic	1.87312	Prob. F (2,28)	0.56801
Obs*R-squared	2.44679	Prob. Chi-Square (2)	0.14010

Computation of the Author, 2021 (Eview-10)

The Prob. Chi-square for table 6 was 0.56801, which is larger than 0.05, thus we accept the null hypothesis that the variables in the model have no serial association.

Test for Heteroscedasticity

The regression model is homoscedastic as shown in table 7 below:

Table 7 Breusch-Pagan-Godfrey Heteroskedasticity Test

F-statistic	1.167442	Prob. F (4,30)	0.1852
Obs*R-squared	1.847005	Prob. Chi-Square (4)	0.1973
Scaled explained SS	1.29210	Prob. Chi-Square (4)	0.1927

Computation of the Author, 2021 (Eview-10)

The Prob. F-value for table 7 is 0.1852, which is larger than 0.05, thus we accept the null hypothesis that the variables in the model are not heteroscedastic.

CUSUM test for parameter instability

The CUSUM test depicts the cumulative sum of the recursive residuals together with the 5% critical lines and does not require a specific date. If the cumulative total falls outside the area between the two critical lines, the CUSUM test indicates parameter instability.

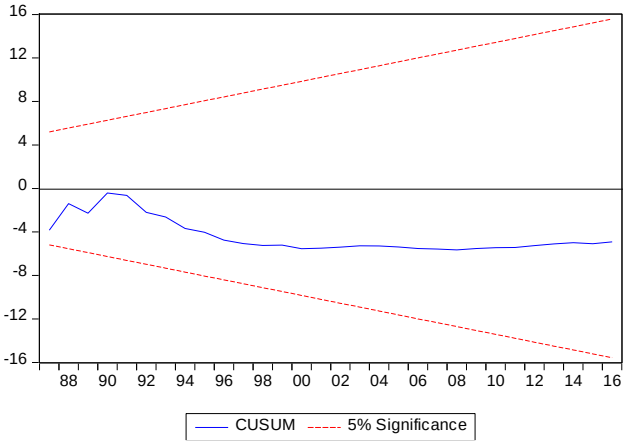

Figure 1 Testing the Parameter stability

Computation of the Author, 2021 (Eview-10)

The CUSUM test result confirms parameter stability since the cumulative total does not fall outside the area between the two crucial lines, as shown in figure 1.

5. DISCUSSION OF FINDINGS

Between the research years, the Government spending (GEXP) variable was similarly found to be adversely and substantially associated to Nigeria's INF. The size of this negative impact, however, is negligible. The function indicated that a unit change in GEXP dropped Nigeria's INF by (an insignificant amount of) -3.07 million on average, while maintaining other variables constant. The findings are consistent with those of George-Anokwuru and Ekpenyong (2020), who found that government spending had a negative impact on inflation throughout the study period, whereas the previous level of inflation had a favorable impact on present inflation.

Finally, the Granger causality test was used, as proposed by Granger (1969). A cointegration relationship implies the existence of causal links (unidirectional or bidirectional) between the variables. Table 5 indicates that there is bidirectional (two-way) causation between government expenditure and inflation, i.e., causality works both ways. Because the computed F is significant at the 5% level, it's enough to say that GEXP causes IFR and IFR causes GEXP, meaning that there is bidirectional causality between GEXP and IFR. The final product is on par with Olayungbo's study (2013) They find a two-way bidirectional relationship between recurrent and capital expenditures and inflation, implying that causation works both ways.

6. CONCLUSION

In most nations across the world, keeping inflation under control has been a primary macroeconomic policy

priority. When there is inflation, not all prices and earnings grow in lockstep, which has a detrimental impact on income distribution. For example, in many nations, pensioners' payouts may not keep pace with inflation, causing them financial hardship. Furthermore, when certain prices are set by law or regulation, they lag behind other prices, causing price distortions and changes in relative costs. Inflation, in general, is bad for long-term economic growth because it lowers living standards and confuses economic decision-making. Furthermore, price rises in one area of the economy may be passed on to other sectors. Fiscal policies also have an impact on inflation, and they advocate for a decrease in total spending in certain sectors by combining overlapping expenditure programs and reprioritizing expenditure to increase budgetary transparency. Based on the research analysis, we can infer that inflation has a large influence on government spending, and government expenditure has a significant impact on inflation.

7. RECOMMENDATIONS

We suggest the following recommendations based on the study's findings:

The government must develop proper fiscal and monetary policies, which must be combined in order to be effective. Control the amount of money in circulation in the economy.

The government should divert spending to productive sectors in the economy in order to raise the supply of products and services in relation to demand, limiting rising inflationary pressures and transforming the economy to be more productive.

To avoid the economy becoming consumption-driven, the government must maintain a strong strategic balance between capital and recurrent expenditure.

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