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EFFECT OF EXTERNAL DEBT ON ECONOMIC GROWTH IN NIGERIA

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ABSTRACT: *This study empirically examined the effect of external debt on economic growth in Nigeria under the period of 37 years (1981-2017). The study specifically examined the influence of external debt, external debt service payment and exchange rate on economic growth proxy as real gross domestic product. The study employed least square econometric technique to ascertain the relationship between external debt variables and economic growth in Nigeria. The study found that external debt and external debt service payment have negative effect on economic growth while exchange rate has positive effect on economic growth in Nigeria. The coefficient of multiple determinations (R^2) showed that approximately 77% of variations in economic growth are explained by the explanatory variables (EXTD, EXTDS and EXR) while the remaining 23% is accounted by factors not specified in the model. However, The Durbin Watson correlation test indicated that there is positive autocorrelation in the model which implied there is about 23% missing variables in the model. The conclusion that may be drawn from the study is that external debt has negative effect on economic growth in Nigeria. Hence, it is recommended that Debt Management Office should set mechanism in motion to ensure that loans were utilized for purposes for which they were acquired and channel towards productive uses and sourcing external debts should be considered as a means of long run development not just for solving short run problems.*

KEYWORD: External Debt, Domestic Debt, Economic Growth, Debt Management, Nigeria

INTRODUCTION

Human wants are insatiable and the means or resources available for the satisfaction of wants are limited in their supply (Olukunmi, 2007). In individual and national lives, the above assertion is true. To meet national wants amidst limited resources, nations might resort to borrowing. Debt is as a result of excessive borrowing. Oyejide, Soyede and Kayode (1985) explained that the aggregate of all claims against the government, held by the private sector of the economy or by foreigners, whether interest bearing or not less is referred to debt. Shortfall in domestic savings to finance productive activities compels nations to borrow (Ezeabasili, 2006).

Debt could be from within a nation's boarder (Internal) or from outside (External). According to World Bank (2004) external debt is referred to accumulated fund owed to non-residents repayable in terms of foreign currency, food or service. The effect of external debt on domestic investment and economic growth of a country has remained questionable for theoretical thinkers, stakeholders and academics alike. There has not been consensus on the impact of external debt on economic growth. External debt may be used to stimulate the economy but whenever a nation accumulates substantial debt, a reasonable proportion of public expenditure and foreign exchange earnings will be absorbed by debt servicing and repayment with heavy opportunity costs (Albert, Brain & Palitha, 2005). Excessive external debt constitutes a major constraint to sustainable economic development and poverty alleviation (Maghyere & Hashemite, 2003; Sanusi, 2003; Berensmann, 2004; Siddique, Selvanathan & Selvanathan, 2015).

Those who argue that external debt has positive effect on the economy do that from the stand point that external debt will increase capital inflow and when used for productive ventures, accelerates the pace of economic growth. The capital inflow may be associated with managerial know-how, technology, technical expertise as well as access to foreign market. The above is in agreement with the views of the Keynesian theory of capital accumulation as a catalyst for economic growth. However, external debt may pose negative effect on investment through debt overhang and credit-rationing problem (Nwannebuike, Ugwu & Onwuka, 2016).

Debt overhang phenomenon is where substantial resources are used for debt servicing such that it stifles economic growth. It becomes a tax on domestic production such that the amount spent hampers meaningful economic growth activities as it reduces resources available to government to implement growth oriented economic policies (Nwannebuike, Ugwu & Onwuka, 2016).

Credit rationing effect results when a country has long accumulated debt acquired from different sources which has become a chronic problem to the country and cannot pay up as and when due. The authorities increase interest rates to narrow savings investment gap, thus affecting new investment, generating greater surplus for debt servicing and repayment. However, this may subsequently depress future growth prospects. The divergent views in literature on the nexus between external debt and economic growth become a motivating factor for the present study.

Objectives of the Study

The main objective of the study is to investigate the effect of external debt on economic growth in Nigeria. However, the specific objectives are to;

i. ascertain the impact of external debt on economic growth in Nigeria.

ii. examine the effect of external debt servicing on economic growth in Nigeria.

iii. establish the impact of exchange rate on economic growth in Nigeria.

Research Hypotheses

The study will be guided by the following null hypotheses:

H_{01}: External debt has no significant impact on Gross domestic product in Nigeria.

H_{02}: External debt servicing has no significant effect on Gross Domestic Product in Nigeria

H_{03}: Exchange rate has no significant impact on Gross Domestic Product in Nigeria

LITERATURE REVIEW

External Debt

The concept of borrowing dates back to the biblical era. When the children of Israel were leaving Egypt, they borrowed whatever they needed from the Egyptians while leaving the land of their captivity. In the modern era, borrowings by countries occur as a result of inability to generate enough domestic savings to carryout productive activities. Such external borrowings by countries are meant to supplement the domestic saving and allow such countries to carry out productive activities (Ezeabesili, 2011). A country can also borrow in the short term, from external sources, to finance current account deficits arising from external disturbances in order to shore up external reserves position and strengthen external liquidity position in the future. Foreign borrowing is seen to be desirable and necessary to accelerate economic growth, provided they are channeled to increase the productive capacity of the economy (Udoffia & Akpanah, 2016).

External debt is an essential source of finance mainly used to augments the local sources of funds for supporting development and other needs of a country. Usually external debt is incurred by a country which suffers from shortages of domestic savings and foreign exchange needed to achieve its developmental and other national objectives. However, if the external debt is not profitably and productively used, the effort of a debtor country in paying the debt becomes a critical concern as such may result to bad debt.

External debt therefore refers to the mobilization of fund and resources generated elsewhere outside the home country. Udoffia and Akpanah (2016) relate external debt to packages that consist of a combination of financial, technical vis-à-vis managerial requirements emanating from outside the country, aimed at supporting economic growth and development and are repayable at determined future date in foreign currency. Anyanwu (1993) in his own opinion sees external debt as the amount, at any given time, of disbursed and outstanding contractual liabilities of residents of a country to non-residents to repay principals with or without interest or to pay interest, with or without principal. Afolabi (1999) sees external debt as credits that are obtained in foreign exchange and are also to be serviced and repaid in international currency. Continuing, he opines that such loans may be bilateral that is negotiated between two countries mainly on mutual basis and in a friendly manner. It may also be multilateral where another party is acting "in-between" the borrowing and the lending parties or where the loan is syndicated in which case one party has to act for the membership of the financing syndicate.

From Anyanwu's perspective of external debt definition, the liabilities that dropped within his core definition include: currency and transferable deposits, other deposits, short-term bills and bonds, long-term loans (not classified elsewhere) and trade credit and advances. Continuing he sees foreign borrowing as a means of supplementing national resources (domestic) an immediate reduction in other uses of resources for either consumption or capital formation.

The World Bank (1998) described external debt as the amount of money at any given time disbursed and outstanding contractual liabilities of residents to pay interest, with or without principal. Many developing countries resort to external borrowing to bridge the domestic resource gap in order to accelerate economic development. It means that the processes are utilized in a productive way that facilitates the external servicing and liquidation of the debt (Oke & Sulaiman, 2012).

Domestic Debt

Asogwa (2008) explained debt as a contractual obligation of owing or accumulated borrowing with a hope of paying back at a futuristic time. From the perspective of the government, debt may be contracted from within the country (domestic debt) using one instrument or the other and denominated in local currency, or from outside the country (external debt) and denominated in foreign currency. In Nigeria, domestic debts are contracted by the Federal Government, states and local governments. Practically, states and local governments can issue debt instruments but are limited in their capacity to do so. Domestic debt instruments in Nigeria mainly consist of treasury bills (TBs), treasury certificates (TCs) Federal Government development stocks (DS), bonds and means advances. The TBs, TCs and DS are marketable and negotiable while bonds and ways and means advances are not, but are rather held solely by the Central Bank of Nigeria (Adofu & Abula, 2010). These debt instruments are usually used to borrow locally in order to close the resource gap between savings and investment. Three reason for government domestic debt according to Alison (2003) are budget deficit financing, monetary policy implementation (i.e., trading of treasury bills in the open market), and development of the financial instruments to deepen the financial market.

Domestic Public Debt is mainly debt owed to holders of Government securities such as Treasury Bills and Treasury Bonds. Governments usually borrow by issuing securities, government bonds and bills. Governments borrow for two reasons namely: when the projected revenue targets fall short of the projected expenditure and to pay off maturing loans (Ponzi games) which is typical with domestic debt (Babu, Kiprop, Kalio & Gisore, 2015). Fry (1997) indicates that reliance on external resources to complement capital formation in the domestic economy is a principal factor causing increasing level of debt. The greater the interest payment and the heavier the deficit on the current account, the heavier the debt burden.

Debt sourced finance represents funds with fixed contractual obligations which will require pledging future resources of the nation as collateral. However, in order to cope adequately in the long run, with servicing requirement, a nation's debt service capacity must increase at a rate higher than that of its financial risk exposure. The non-debt resources on the other hand represent funds flow without fixed or compulsory servicing obligations on the government. The magnitude and regularity of such resources however, depend on perspective of foreign investors on the investment environment in the recipient country.

Essentially, the domestic debts entail debt instruments issued by the Federal, states and local governments and denominated in local currency (Titus, Chidi, Tochukwu & Babatunde, 2016) but excludes contractor debts and supplier credit owed by the governments, as well as contingent liabilities and inter-agency debts.

Economic Growth

Economic growth occurs whenever people take resources and rearrange them in ways that are more valuable. Economic growth refers to the quantity of goods and services produced; it says nothing about the way in which they are produced. Economic growth can be measured in nominal terms, which include inflation, or in real terms, which are adjusted for inflation i.e. by the percent rate of increase in the gross domestic product (GDP). Economic growth measures growth in monetary terms and looks at no other aspects of development (Ayres & Warr, 2010).

Economic growth may be positive or negative. Negative growth can be used to describe a situation where the economy is shrinking. Negative growth is associated with economic recession and economic depression. Gross national product (GNP) is sometimes used as an alternative measure to gross domestic product. In order to compare multiple countries, the statistics may be quoted in a single currency, based on either prevailing exchange rates or purchasing power parity. Then, in order to compare countries of different population sizes, the per capita figure is quoted. To compensate for changes in the value of money (inflation or deflation) the GDP or GNP is usually given in "real" or inflation adjusted, terms rather than the actual money figure compiled in a given year, which is called the nominal or current figure (Ayres & Warr, 2010).

A fundamental requisite to economic development in a country is economic growth. This informs why in Nigeria growth continuously dominates the main policy thrust of government's development objectives. Essentially, economic growth is associated with policies aimed at transforming and restructuring the real economic sectors. Nevertheless, the lack of sufficient domestic resources, savings and investment to support and sustained the sectors is a major impediment to economic development in the country because of the gap between savings and investment (Imimole & Imoughele 2012). Ullah and Rauf (2013) noted that whenever there is increase in real GDP of a country it will boosts up the overall output and we called it economic growth. The economic growth is helpful to increase the incomes of the society, help the nation to bring the unemployment at low level and also helpful in the deliveries of public services.

Haller (2012) opined that economic growth is a complex, long-run phenomenon, subjected to constraints like: excessive increases of population, limited resources, inadequate infrastructure, inefficient utilization of resources, excessive governmental intervention, institutional and cultural models that make the increase difficult, etc. Economic growth is obtained by an efficient use of the available resources and by increasing the capacity of production of a country. It facilitates the redistribution of incomes between population and society. The cumulative effects, the small differences of the increase rates, become big for periods of one decade or more. It is easier to redistribute the income in a dynamic, growing society, than in a static one.

Review of Empirical Literature

In Greece, Panagiotis (2018) investigates the nexus between economic growth and several factors (investment, private and government consumption, trade openness, population growth and government debt), where imbalances persist several years after the financial crisis. The results reveal a long-run relationship between variables. Investment as private and government consumption and trade openness have positive effect on growth. On the other hand, there is a negative long-run effect of government debt and population growth on growth. Furthermore, the study addresses the issue of break effects between government debt and economic growth. The results indicate that the nexus between debt and growth depends on the debt breaks. Specifically, at debt levels before 2000, increases in the government debt-to-GDP ratio are associated with insignificant effects on economic growth. However, as government debt rises after 2000, the effect on economic growth diminishes rapidly and the growth impacts become negative.

Adamu, Salihu, Musa, Abdullahi and Bello (2018) enhance the existing literature on the debt growth-nexus by analyzing the relationship between debt variables and economic growth within Solow (1956) growth framework. The study employs econometric technique of Autoregressive Distributive Lag (ARDL) model and applied on time-series data for Nigeria spanning between 1981 and 2016. The finding of the study explored that external debt and economic growth are negatively related both in the short and long runs. The evidence suggests that increase in external debt will lead to decline in economic growth. Based on the findings, the study suggests that debt service obligation should not be allowed to rise more than foreign exchange earnings and that the loan contracted should be invested in profitable and productive ventures, which will generate a reasonable amount of money for debt repayment. Paul (2017) analyses the impact of external debt on economic growth in Nigeria. Data are collected from secondary sources. The variables on which data are collected include; Gross Domestic Product, external debt services, external debt stock, external reserve, and exchange rate. The scope of the study covers the period from 1985 to 2015. Ordinary least square regression, ADF unit root test, Johansen cointegration and error correction test were the basis for analysis. Findings reveal that debt service payment has insignificant negative effect on Nigeria's economic growth while external debt stock has significant positive effect on Nigeria's growth index. The control variables: external reserve and exchange rate have significant positive effect on growth. The ADF unit root test shows that all the variables are not stationary at levels but at first difference. Johansen cointegration test shows long-run relationship between external debt and growth index (GDP). It also shows that the variables have at least one common stochastic trend driving the relationship between them. The causality test indicates unidirectional causality between external debt and GDP. From the findings, the study recommends that government should apply external loans to infrastructural development; improve business environment through legislation; initiate proper debt management policies and substitute external borrowing for human capital development.

Aguwamba and Adeghe (2017) examines the external debt crisis and Nigeria's economic growth. It covers a period of 30 years (1979-2008) with GDP, external debt and external debt service payments as the variables. The GDP is the dependent variable, while external debt and external debt service payments are the independent variables. Cointegration econometric model is used for the estimation and the Unit root test is conducted in order to ascertain the stationarity of the variables. The results indicate that the GDP has positive relationship with the external debt and negative relationship with the external debt service payments.

Amassoma and Adeniran (2017) explore the nexus between external debt and economic growth in Nigeria between the periods 1980 to 2014. The study adopts OLS regression method to ascertain the existing relationship. The results show that external debt exerts a negative and significant effect on private investment in Nigeria, while domestic debt had a positive and significant influence on private investment in Nigeria during the study periods, indicating that external debt impedes private investment in Nigeria. The study concludes that external debt is inversely related to private investment, meaning that an increase in external debt goes a long way in reducing private investment which slows down economic growth in the country. It is hence recommended that there is the need for the government to focus more on domestic investment and lessen the concentration on private investment.

Ukpe, Umeh, Ater and Asogwa (2017) address the impact of private investment and external debt on economic growth in Nigeria for the period of 1980 to 2016. Secondary data were collected and analysed using fully modified ordinary least square. The result showed that the coefficient of determination (R2) was 0.65 indicating that 65% of the variation of agricultural output was explained by public external debt, foreign direct investment, domestic private investment and labour. The result also showed that the coefficients of public external debt (-0.315) and domestic private investment (-0.488) were significant and negative indicating that unit increase in public external debt and domestic private investment decrease agricultural growth by 0.315 metric tons and 0.488 metric tons respectively. In contrast, the coefficient of labour (1.487) was positive and significant indicating that unit increase in labour will increase agricultural output by 1.487 metric tons. It was recommended that specialized development agencies should be set up with the aim of implementing and evaluating government policies on foreign external debt and economic growth. Ibrahim (2016) discusses the effects of external debt on public capital investment in Nigeria from 1970 to 2013 using autoregressive distributed lag (ARDL) bound testing approach. The findings that study reveals are that external debt and debt service exert negative impact on public capital investment, but the current real GDP is positive. The evidence suggests that external debt does not influence public investment over the period under study. At longer horizon, it is confirmed that the nature of poor domestic savings and investment causes higher debt service payments and crowd out available resources for investment in economic and social sectors. It is proffered that policy makers should adhere strictly to the appropriate use of debt through efficient investment, so that the debt service payments do not exceed the country's payment capacity. Okwu, Obiwuru, Obiakor and Oluwalaiye (2016) employ relevant econometric analysis to examine the effects of domestic debt on economic growth in Nigeria during the 1980-2015 periods. Variables of analytic interest were real gross domestic product (RGDP) as economic growth proxy, and domestic debt stock (DDS) and domestic debt servicing expenditure (DDSE) as determinant variables; with government expenditure (GEXP) and banks' lending rates (BLR) exerting moderating influence. On individual merits of the explanatory variables, the results showed evidence of significant short and long-run positive effect for DDS; negative effect for DDSE but insignificant negative effect for BLR. The variables jointly exerted significant effect and exhibited considerably high power in explaining variations in growth of the economy during the period. The conclusion was that domestic debt had short and long-run growth potentials. Thus, adequate deployment of domestic debt to key sectors of the economy was recommended for sustainable short run growth that might possible translated to long run growth.

Akinwunmi and Adekoya (2016) examine external reserves management and its effects on Nigerian economic growth from 1985 to 2013. Secondary data were sourced from Central Bank of Nigeria statistical bulletin, Nigeria Bureau of Statistics of various editions and other related Journals. Augmented Dickey Fuller unit root test, ordinary least square and Johansen cointegration test were conducted. The study reveals that there is a significant relationship between external reserves and the explanatory variables. Unit root test showed that at first differential level, EXR, MPR. IFR, FDI are stationary; and co-integration test shows that there is a proof of co-integration between the variables. The results from regression analysis further shows that explanatory variables explain and account for 90% variations in external

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reserves which is an evidence of good fit of the model. In addition, the multiple regression results show that GDP, MPR and FDI are highly statistically significant while IFR and EXR are statistically insignificant. This implies that FDI, MPR and GDP contributes immensely to the external reserves position in Nigeria. It also implies that a good performance of the economy is a positive signal for inflow of foreign direct investment which impact the reserves position of the economy. Sulaiman and Azeez (2012) employ ordinary least square, ADF unit root test, Johansen co-integration test and error correction method (ECM) techniques to study effect of external debt on the economic growth of Nigeria. The co-integration test shows that long-run equilibrium relationship exist among the variables, the findings from the error correction method show that external debt has contributed positively to the Nigerian economy. The study recommends that government should ensure economic and political stability and external debt are acquired largely for economic reasons rather than social or political reasons.

METHODOLOGY

Model Specification

Special reference is made to the work done by Amassoma (2011), which is modified for the purpose of the study.

The present study adapts the model proposed by Amassoma (2011) by dropping internal debt, this is because internal debt measure domestic debt and this study is purely external debt and economic growth which silence domestic debt. The study therefore includes exchange rate and external debt servicing variables into the model. The justification for the inclusion of exchange rate is to account for the rate at which the debt is being serviced over a year. Based on this, the proposed model for the study will therefore be stated as:

$$RGDP = f\ (EXTD, EXTDS, EXR) - 3.1$$

Where:

RGDP = Real gross domestic product expressed in constant term; *EXTD* = External debt; *EXTDS* = External debt servicing; *EXR* = Exchange rate; *et* = error term

Estimation Technique

For easy analysis, this study adopts the ordinary least square method of multiple regression analysis. This is based on the various desirable of the ordinary least square which many other estimation techniques do not possess. These include the properties of Best, Linearity, Unbiasedness and Efficiency (BLUE). Some of these desirable properties are summarized in the BLUE properties of OLS.

RESULT AND DISCUSSION

Summary of OLS Result

Variables	Co-efficient	Standard error	t-statistics	Probability
C	4.568415	0.160843	28.40301	0.0000
EXTD	-0.213615	0.069048	-3.093745	0.0043
EXTS	-0.053322	0.019121	-2.788673	0.0092
EXR	0.446532	0.061396	7.272997	0.0000

R² = 0.766256 Adj R^2= 0.742076 ***D.W.*** = 0.347424
N = 37 ***F-stat=*** 31.68917 Prob= 0.000000
Source: Eview 9.0

The relationship between the dependent variable (RGDP) and the independent variables (EXTD, EXTDS and EXR) in the table above, this can be expressed mathematically as:

RGDP = 4.568415 - 0.213615EXTD - 0.053322EXTDS + 0.446532EXR + μ ………… 4.1

DISCUSSION OF FINDINGS

Empirically, the study reviews the effects of external debt on economic growth in Nigeria for the period of 37 years which spanned from 1981 to 2017. Using least square multiple regression, the study found that the variables in the study have significant effects on economic growth. Specifically, exchange rate has positive effect on economic growth which implies that exchange rate has a power influencer on economic growth by 44.6% changes. Conversely, external debt and external debt service payment have negative effects on economic growth in the study period which implied that an attempt to increase external debt and its service payment in the country will simultaneously result to 21.3% and 5.33% changes respectively. The coefficient of multiple determinations (R^2) showed that approximately 77% of variations in economic growth are explained by the explanatory variables (EXTD, EXTDS and EXR) while the remaining 23% is accounted for by factors not specified in the model. However, The Durbin Watson correlation test indicated that there is positive autocorrelation in the model which implied there is about 23% missing variables in the model.

Implication of Findings

The empirical evidence shows that there is a negative relationship between economic growth and the present level of external debt in Nigeria. This is evident by negative effects of external debt and external debt service payment on economic growth in the analysis. The result indicates that within the study period, an attempt to increase external debt will reduce economic development in the short run because capital is not use for investment. From this result it becomes clear that external debt is unfriendly to economic development. The implication that the result poses is that accumulation of the external debt puts pressure on economic growth as external debt repayment and servicing reduces the foreign exchange earnings of the country. The fiscal burden of debt servicing has been observed as extremely hostile to economic development in Nigeria and has been further observed as an important reason for the failure of structural adjustment programmes to restore economic growth in

Nigeria (Isa, 2004; Emori, 2015). This therefore implies that an effort to reduce the mounting huge external debt, Nigerian government frequently diverts resources to take care of pressuring debt service obligations instead of allocating the resources to the development of infrastructure that would have improve the well being of the citizenry.

Conclusively, the trend of debt in Nigeria within the last 3 years is alarming as such external debt and its service payment have negative effect on economic growth. The significant effect implies that if the foreign borrowing were used for its major purpose without siphoning or diversion to unproductive sector it will enhance economic growth. Therefore, Nigeria government should intensify measure to reduce the debt collection of the country and simultaneously increase the development of real sector.

CONCLUSION AND RECOMMENDATIONS

This study examines the effect of external debt on economic growth in Nigeria under the period of 37 years (1981-2017). The study employed least square econometric technique to ascertain the relationship between external debt variables and economic growth in Nigeria under the study period. External debts are necessary to meet shortfall internal resources, and stimulate the economy. However, it must be properly utilized to avoid serious consequences. Borrowing is not the most important issue but the use to which the fund is deployed. This should be the most important thing agitating the mind of any good accountant and Economist whenever external debt is contemplated. It should be approached with caution, ensuring optimal utilization and higher return than the interest (cost of fund) (Nwannebuike, Ugwu & Onuka, 2016). External debt is a proportion of the nation's national debt sourced from international individuals, agencies and/or government. It has been observed and confirmed by this study that external debt contributed in negative direction toward economic growth in Nigeria under the study period. It is a clear fact from observable reality that ineffective utilization of debt will make repayment a difficult task, the interest will keep accruing (a time almost to the tune of the capital), then repayment becomes a questionable problem and such debt will become a bad debt (Olasode & Babatunde, 2016).

To sum, exchange rate has significant positive effect on the Nigerian economy while external debt stock and debt service payment have significant negative effect on the Nigerian economy. The conclusion that can be drawn from this study is that external debt have significant negative effect on economic growth in Nigeria. The result of the study is in connection and in consistence with the study of Adamu, Salihu, Musa, Abdullahi and Bello (2018) and Nwannebuike, Ike and Onuka (2016) who concluded that exchange rate had significant positive impact on the Nigerian economy while external debt stock and debt service payment had significant negative impact on the same economy.

Arising from the evidences offered by the empirical results, it is pertinent to offer some policy options that could strengthen the connection between external debt and economic growth in Nigeria.

i. Debt Management Office should set mechanism in motion to ensure that loans were utilized for purposes for which they were acquired and channel towards productive uses and sourcing external debts should be considered as a means of long run development not just for solving short run problems.

ii. Debt Management Office should set maximum limit of loans state and federal governments could be allowed to acquire based on certain stipulated criteria.

iii. Nigeria should use her accumulated external foreign reserves instead of incurring more external debts, as this will ensure increase in real economic growth and reduce capital flights through repayments of debts to external sources.

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