

Debt Profile And The Nigerian Economy

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Abstract

This study investigated debt profile and the Nigerian economy. Annual time series data sourced from Central Bank of Nigeria statistical bulletin as well as the publications of National Bureau of Statistics (2000 to 2019) were used to analyze and estimate the multiple regression model specified, with the aid of Econometric views (Eviews) 8.0 version. The study measured economic performance which is the dependent variable by Gross Domestic Product (GDP) while debt profile which is the independent variable was proxy by domestic debt to GDP ratio, external debt to GDP ratio and total debt to total revenue ratio. The parameters of the model were estimated using Ordinary Least Square (OLS) technique. The study found that: a negative and significant relationship exists between domestic debt to GDP ratio and growth in GDP, a negative and significant relationship between external debt to GDP ratio and growth in GDP while a positive and significant relationship exists between total debt to total revenue ratio and growth in GDP in Nigeria. The study concluded that debt burden is an important factor indicator that influences the level of economic activities in Nigeria. The study recommended that loans contracted should be invested in profitable ventures, which will generate a reasonable amount of money for debt repayment.

Keywords: Domestic debts, external debts, debt profile, economic growth

Introduction

In the past four decades Nigeria's macroeconomic goals have been to achieve sustainable economic growth, increase in aggregate output, price stability and full employment. For this to be possible, government intervenes in the market economy as justified by the Keynesian's economist as to bridge supply-demand gap by providing public goods for the citizen. This led to government deficit budget and a means of financing it. Public debt is a government receipt aimed at bridging the savings-investment gap in the government. Economic theory suggests that reasonable level of borrowing by a developing country is likely to enhance its economic growth (Abdelmawla and Mohammed, 2005). According to Onoh (2007) in his book "Dimension of Nigerian monetary and fiscal policies", when a government borrows, the debt is a public debt. However, this debt could be either internal or external and are incurred by the government through borrowing in domestic and international markets so as to finance domestic investments. One of the reasons why government has to borrow is to fulfil its major function of mobilizing resources for rapid economic growth and development. In other words, debts are classified into two i.e productive and dead weight debt. When a loan is obtained to enable a state or nation purchase some sort of asset, the debt is said to be productive. An example is the money borrowed for acquiring factories, electricity and so on. However, when a debt is undertaken to finance wars and expenses on current expenditure, it is referred to as dead weight debt.

Theoretically and empirically, there are two opposite effect of debt. Debt when properly accounted for and invested in the domestic economy have the capacity of increasing the productive capacity of the economy by putting idle resource to work, increase production beyond national consumption. However, the debt structure of the country affects individual citizens, government aid and corporate organizations such as the banking institutions. For instance, findings indicate that government borrowing crowd out investment; this means discouraging savings as a result of debt servicing. This is one of the negative effects of public debt (Adesola, 2009). Furthermore Fosu (2019) observed that high debt service payments shifts spending away from health, educational and social sectors. This obscures the motive behind external borrowing which is to boost growth and development rather than get drowned in a pool of debt service payments which eats up most of the nation's resources and hinders growth due to high interest payments on external debt. Nigeria as a developing nation has adopted a number of policies such as the Structural Adjustment Programme (SAP) of 1986 to liberalize her economy and boost Gross Domestic product (GDP) growth. In a bid to ensure the implementation of these policies, the government embarked upon massive borrowings from multilateral sources which resulted in a high external debt service burden and by 1992, Nigeria was classified among the heavily indebted poor countries (HIPC) by the World Bank.

According to Omotoye, et al. (2016) Nigeria is the largest debtor nation in Sub Saharan Africa. When compared with other Sub Saharan nations such as South Africa, Nigeria's external debt stock follows an upward pattern over the years while the former is relatively stabilized (Ayadi and Ayadi, 2008). Nigeria's external debt stock rose from US\$28454.8 million in 1997 to US\$31041.6 and US\$37883.1 million in 2001 and 2004 with 80.3, 64.67 and 52.58 percentages of GDP respectively. On the other hand, South Africa's external debt stock stood at US\$25272.4 million, US\$24050 million and US\$27112.4 million in 1997, 2001 and 2004 with 16.98, 20.34 and 12.52 percentages of GDP respectively. The unabated increase in the level of external debt service payments has led to huge imbalances in fiscal deficits and budgetary constraints that have militated against the growth of the Nigerian economy. The resultant effect of the debt quagmire in Nigeria could create some unfavourable circumstances such as crowding out of private investment, poor GDP growth e.t.c (Ajisafe et al., 2006). This study is therefore geared towards investigating the effect of debt burden on the Nigerian economy.

Conceptual review

Origin of Nigeria's public debt

Nigeria's external indebtedness can be traced back to the pre-independence period when in 1958 a loan of US\$28 million dollars was contracted from the World Bank for railway construction. This debt did not pose a serious burden reason being that it was acquired on soft terms i.e. with no interest or below market rate of interest. After this period, the need for external aid was relatively low until in 1977/1978 when there was a fall in world oil prices which in turn reduced the nation's oil receipts. Before this period, Nigeria was experiencing abundance in oil receipts especially with the oil boom of 1973-1976. After crude oil was first discovered in 1956, it became a major source of foreign exchange earnings as there was a gradual drift from agriculture which had been the dominant provider of export earnings, employment e.t.c to near total dependence on oil as the mainstay of the economy. Following the fall in oil prices, it became necessary for the government to correct balance of payment difficulties and finance projects. This led to the first major borrowing of US\$1 billion which is referred to as the JUMBO LOAN in 1978 from the international capital market (ICM). Although this loan was used to finance various medium and long term infrastructural projects, the returns obtained from these projects were not enough to amortize the nation's debts as many of the projects as included in the Fourth National Development Plans (1981-1985) involved mainly the use of imported materials.

In 1979, there was a recovery in the oil market and oil was sold in Nigeria at US\$39.00 per barrel which led to the belief that the economy was bouncing back. But due to the fact that there was excessive importation, it resulted in over-invoicing of imports and under-invoicing of exports and in 1982 when there was another collapse in world oil prices, it caused severe strains and stresses on the economy. Foreign exchange was declining rapidly and there were large amount of deficits in government financing. In the face of drastic oil downturn and dwindling oil reserves, the rate of borrowings increased from the international capital market (ICM). At this point the nation's debt profile had begun rising astronomically due to the increasing external debt service payments. In 1980 external debt stood at US\$8.5 billion and by 1985, it nearly reached US\$19 billion, showing an increase of about 45.02%. The increases in debt service payments interests resulted in mounting of trade debts arrears. By 1997, the nation's debt stock stood at US\$27.0878 billion; US\$18.9804 billion Paris Club debt; US\$4.3727 billion Multilateral debt; \$1.6125 billion Promissory notes and US\$0.7919 billion Non Paris Bilateral debt (Ministry of Finance, 1997). Due to the rise in external debt, there was a corresponding increases in external debt servicing ratios; debt/GDP and debt/export earnings. As at December 31st 2001, the external debt stock stood at US\$28.35 billion which was about 59.4% of GDP and 153.9% of export earnings.

External debt management in Nigeria

In the 1980, the management of the external debt became major responsibility of the Central Bank of Nigeria (CBN). This necessitated the establishment (setting up) of a Department in collaboration with Federal Ministry of Finance to the management of external debt, although, the debt management strategies and measures varied from time to time since the early 1980s when the external debt became pronounced. The following measures were used by the Government as guidelines to external borrowing. Economic sector should have positive Internal Rate of Return (IRR) as high as the cost of borrowing i.e. interest External loans for private and public sectors projects with the shortest rate of return should be sourced from the international capital market while loans for social services or infrastructure could be sourced from confessionals financial institutions.

- ❖ State Government, Parastatals, Private sectors borrowing receives adequate approval from the Federal Government so as to ensure that the borrowing conforms to the national objectives.
- ❖ Projects to be financed with external loan should be supported with feasibility studies which include loan acquisition, deployment and retirement schedule.
- ❖ State Governments and other agencies with borrowed funds should service their debts through the foreign exchange market and duly inform the Federal Ministry of Finance for record purposes. Any default will attract deduction (in Nigeria equivalents) at source before the release of statutory allocations.
- ❖ Private sector, industries that are export: oriented are expected to service their debt from their export earnings while others should utilize the Foreign Exchange Market facilities for debt servicing. The government over the years adopted the under listed strategies and measures to deal with the debt problem.

They include:

- ❖ Embargo on new Loans and Directives to State Government to restrict external borrowing to the barest minimum: The embargo was to check the escalation of total debt stock and minimize additional debt burden. However, these have not been particularly effective as indiscriminate quest for external loans have not been adopted. Although rescheduling has conferred short term relief or debt service obligations, the debt overhang has however hardly been abated as the debt stock has continued to increase significantly.
- ❖ Limit on debt service payments: This requires setting aside portion of export earnings to allow for internal development.
- ❖ Debt Restructuring: This involve the reduction in the burden of an existing debt through refinancing, rescheduling bring back, issuance of collateralized bonds and the provision of new money. The Federal Government in year 2001 established a semi-autonomous debt management office under the Presidency. The creation of DMO (Debt Management Office) consolidated the debt management functions in a single agency, ensuring proper coordination of the country's debt recording and management activities, including debt service forecast, debt service repayments, and advising on debt negotiation as well as new borrowings.

Nigeria external debt servicing

The major challenge faced by the debt management office is ensuring that a reasonable level of resources are earmarked for debt servicing to avoid the risk of default and to maintain conducive relations for debt relief negotiations with the creditors. Also, the DMO faces the challenge of ensuring that budget resources are release in time to effect debt service payment since much of Nigerian's debt stock build-up was accounted for by the capitalization of interest arrears and penalties for default. Debt service payments to the World Bank are due every 15 days while ADB (African Development Bank) service payments occur frequently. The debts are not subject to debt relief or rescheduling and in case of default, they carry stiff consequences with sanctions coming 30 days after due date. The implications for default include

- ✓ Prohibition of borrower/guarantor from signing new loan or guarantee agreement with the background.
- ✓ Suspension of disbursement in respect of all Bank group loans granted to the borrower/guarantor and lastly.
- ✓ Suspension of the granting of any new loans by the Bank group to the borrower/guarantor. The impositions of the above sanctions adversely affect the credit-worthiness of a Country as well as access to further foreign credits or loans. It is therefore to be avoided by all means.

a. Paris club

Failure of our debt service obligation will undermine Nigerian's effort to obtain substantive debt relief over the medium term coupled with the inability to benefit from normal credit facilities as Export credit agencies in Paris club creditor countries in default of debt service payment. Also business and government agencies from such debtor countries seeking to import goods and services are required to pay the full 100% upfront, even against deliveries that will take several months and at times years.

b. Bilateral

Defaulters in this category incur penalty charges in the form of late interest, which are usually about 1-3% above the normal interest charged.

c. London club

The consequences of defaulting are stiff as the instruments carry legal obligations e.g. If par bonds on promissory notes payment is not received as at when due, creditors could acquire the assets of the Central Bank of Nigeria CBN and Nigerian National Petroleum Corporation NNPC anywhere in the world, as Nigeria has expressly waived her sovereign immunity under the terms of the agreement. In line with the desirable consequences of default in debt service payments the best arrangement must be put in place from time to time in response to changes in the economy and the polity. In order to facilitate the implementation of a new debt service arrangement, the DMO has agreement with the debtors on the nation's external debt stock and debt service obligation so that levels of government and their agencies that contracted the loans would know their respective stock of debt and the required amount for servicing.

Theoretical review**The dual-gap theory**

Omoruyi (2015) stated that most economies have experienced a shortfall in trying to bridge the gap between the level of savings and investment and have resorted to external borrowing in order to fill this gap. This gap provides the motive behind external debt as pointed out by (Chenery, 1966) which is to fulfill the lack of savings and investment in a nation as increases in savings and investment would vis-à-vis lead to a rise in economic growth (Hunt, 2007). The dual-gap analysis is provides a framework that shows that the development of any nation is a function of investment and that such investment requires domestic savings which is not sufficient to ensure that development take place (Oloyede, 2012). The dual-gap theory is coined from a national income accounting identity which connotes that excess investment expenditure (investment-savings gap) is equivalent to the surplus of imports over exports (foreign exchange gap).

Empirical review

An empirical investigation conducted by Audu (2014) examines the impact of external debt on the economic growth and public investment of Nigeria. The study carried out its analysis using time series data covering the period from 1970- 2002. The Johansen Co-integration test and Vector Error correction method econometric techniques of estimation were employed in the study. The study concluded that Nigeria's debt service burden has had a significant adverse effect on the growth process and also negatively affected public investment. Ayadi and Ayadi (2018) examined the impact of the huge external debt, with its servicing requirements on economic growth of the Nigerian and South African economies. The Neoclassical growth model which incorporates external debt, debt indicators, and some macroeconomic variables was employed and analyzed using both Ordinary Least Square (OLS) and Generalized Least Square (GLS) techniques of estimation.

Their findings revealed that debt and its servicing requirement has a negative impact on the economic growth of Nigeria and South Africa. Safdari and Mehrizi, (2017) analyzed external debt and economic growth in Iran by observing the balance and long term relation of five variables (GDP, private investment, public investment, external debt and imports). Time series data covering the period 1974-2017 was used and the vector autoregressive model (VAR) technique of estimation was employed. Their findings revealed that external that has a negative effect on GDP and private investment and public investment has a positive relationship with private investment.

Another study by Ogunmuyiwa (2011) examined whether external debt promotes economic growth in Nigeria using time series data from 1970-2007. The regression equation was estimated using econometric techniques such as Augmented Dickey-Fuller test, Granger causality test, Johansen co-integration test and Vector Error Correction Method (VECM). The results revealed that causality does not exist between external debt and economic growth in Nigeria. Suliman et al (2012) carried out a study on the effect of public debt on the economic growth of Nigeria. Annual time series data covering the period from 1970-2010 was used. The empirical analysis was carried out using econometric techniques of Ordinary least squares (OLS), Augmented Dickey-Fuller unit root test, Johansen Co-integration test and error correction method. The co-integration test shows long-run relationship amongst the variables and findings from the error correction model revealed that public debt has contributed positively to the growth of the Nigerian economy. Faraji and Makame (2013) investigated the impact of external debt on the economic growth of Tanzania using time series data on external debt and economic performance covering the period 1990-2010. It was observed through the Johansen co-integration test that no long-run relationship between external debt and GDP. However the findings show that external debt and debt service both have significant impact on GDP growth with the total external debt stock having a positive effect of about 0.36939 and debt service payment having a negative effect of about 28.5 17. Ejigayehu (2013) also analyzed the effect of external debt on the economic growth of eight selected heavily indebted African countries (Benin, Ethiopia, Mali, Madagascar, Mozambique, Senegal, Tanzania and Uganda) through the debt overhang and debt crowding out effect with ratio of external debt to gross national income as a proxy for debt overhang and debt service export ratio as a proxy for debt crowding out. Panel data covering the period 1991-2010 was used. The empirical investigation was carried out on a cross-sectional regression model with tests for Stationarity using Augmented Dickey Fuller tests, heteroskedasticity and ordinary regression. The concluding result from estimation showed that external debt affects economic growth through debt crowding out rather than debt overhang.

Research methodology

This study adopts the quasi experimental research design. This study will make use of time series data for gross domestic product, domestic debt, external debt, total debt and internal debt. The sample for this study is a yearly time-series data which spans Nineteen years (19 years) from 2000 to 2019. The data will be sourced mainly from Central Bank of Nigeria (CBN) Statistical Bulletins, National Bureau of Statistics, and relevant journals. The variables of this study are classified as dependent variable and independent variable. The dependent variable is economic performance (growth in GDP) while the independent variable is debt burden (domestic debt to GDP ratio, external debt to GDP ratio and total debt to total revenue ratio). The method of data analysis to be used in this study is the Ordinary Least Square method (OLS).

Model specification

Functionally, the model is expressed as:

$$GGDP = f(DDGR, EDGR, TDRR)$$

Econometrically, the model is expressed as:

$$GGDP = b_0 + b_1 (DDGR) + b_2 (EDGR) + b_3 (TDRR) + \mu_1 \quad 2$$

Where:

GGDP = growth in GDP

DDGR = domestic debt to GDP ratio

EDGR = external debt to GDP ratio

TDRR = total debt to total revenue ratio

f = function of

b_0 = Regression intercept/constant variable

$b_1 - b_3$ = estimated parameters

μ_1 = error term

Data analysis

Table 1: Multiple regression analysis results

Dependent Variable: GDP				
Method: Least Squares				
Date: 02/11/21 Time: 09:24				
Sample: 2000 2019				
Included observations: 19				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.322362	0.105589	40.93578	0.0000
DDGR	-1.054634	0.037711	-7.906606	0.0000
EDGR	0.203335	0.111953	-3.816252	0.0089
TDRR	0.038754	0.037439	4.035115	0.0089
R-squared	0.915363	Mean dependent var		4.264859
Adjusted R-squared	0.906899	S.D. dependent var		1.953116
S.E. of regression	0.174965	Akaike info criterion		0.159064
Sum squared resid	1.510772	Schwarz criterion		0.347657
Log likelihood	1.693570	Hannan-Quinn criter.		0.218129
F-statistic	112.8152	Durbin-Watson stat		1.806975
Prob(F-statistic)	0.000000			

Source: Extraction from E-views

Domestic debt to GDP ratio (DDGR)

The result shows that a negative relationship exists between domestic debt to GDP ratio (DDGR) and growth in GDP (GGDP). The coefficient of domestic debt to GDP ratio (DDGR) which is -1.054634 indicates that a unit increase in domestic debt to GDP ratio (DDGR) will bring about 1.054634 decrease in growth in GDP (GGDP).

External debt to GDP ratio (EDGR)

Also, a negative relationship exists between external debt to GDP ratio (EDGR) and growth in GDP (GGDP). The coefficient of external debt to GDP ratio (EDGR) which is -0.203335 indicates that a unit increase in external debt to GDP ratio (EDGR) will amount to 0.203335 decrease in growth in GDP (GGDP).

Total debt to total revenue ratio (TDRR)

Finally, a positive relationship exists between total debt to total revenue ratio (TDRR) and growth in GDP (GGDP). The coefficient of total debt to total revenue ratio (TDRR) which is 0.038754 indicates that a unit increase in total debt to total revenue ratio (TDRR) will amount to about 0.038754 increase in growth in GDP (GGDP).

Conclusion

This study examined the effect of debt burden on economic performance in Nigeria. The study found that Domestic Debt and External Debt proxies of debt burden (domestic debt to GDP ratio, external debt to GDP ratio) exert negative impact on Gross Domestic Product. This means that an increase in external debt and domestic debt burden will reduce the growth of GDP in Nigeria while Total Debt Burden exhibits positive and strong impact on GDP. Conclusively, the study concludes that debt burden is an important factor indicator that influences the level of economic activities in Nigeria.

Recommendations

1. Domestic debts funds should be channeled to juicy investment in the various sectors that can increase Gross Domestic Product (GDP).
2. Funds from external debts should also be channeled to capital projects that can yield returns that will be sufficient to service the debts.
3. Government should not default in servicing debts so that we don't experience debt over hang.

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