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Foreign Debts and Economic Development in Nigeria

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Abstract: Most governments in African countries today often blamed their non- performances on the huge debts inherited from successive governments and the irony of it is that most of them will thereafter add to the burden of debt instead of reducing it. This scenario necessitated the study to investigate the impact of foreign debt on economic development in Nigeria for the period 1981-2019 using time series data. The study test for both long and short run using Augmented dickey fuller unit root test, Bound test, ARDL model, Restricted Error Correction Mechanism(ECM) and Granger Causality Test. An empirical investigation was conducted on Real per capita income, external debt stock, debt servicing, foreign direct investment inflows and gross fixed capital formation. The results on external debt produced negative impact on economic development and there is no bi-directional causal relationship that exists between external debt and economic development. The study recommends that prompt payment of debt will help to avoid its accumulation and loans should be channel towards productive uses

Keywords: external debt, economic development, real per capita income, debt servicing.

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Introduction

Nigeria as one of the developing countries in the world have often contracted large number of external debts, that has led to the mounting of debt arrears at highly concessional interest rates. The genesis of Nigeria's debt service burden dates back to 1978 after a fall in world oil prices. Prior to this occurrence, Nigeria had incurred some minor debts from World Bank in 1958, a loan of US$28million dollars for railway construction and the Paris Club Debtor Nations in 1964 from the Italian government with a loan of US$13.1 million for the construction of the Niger dam. The first major borrowing of US$ 1billion known as the "Jumbo loan" was in 1978 from the International Capital Market (ICM) (Adesola, 2009). Nigeria 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 (2021), even with the huge infrastructural deficit, thousands of abandoned projects littered around the country, high level of unemployment and high incidence of poverty rate.

The country's current economic performance has been uninspiring despite the enormous amount of money the country has borrowed. Happenings in the recent time in Nigeria have led to increasing concerns about the possible adverse consequences of the size of external debt both in the short and long run. Nigeria has been on deficit budget for so many years, hence, the justification for foreign debt is to create more employment opportunities and improve the standard of living of Nigerians. Despite the huge external debt, the country has shown little or nothing in terms of infrastructural development, though, foreign debt is a tool to grow an economy but the inability of the government economy to effectively meet its debt servicing requirements has exposed the country to a high debt service burden. The outcome effect of this debt service burden has created additional problems for the nation particularly the increasing fiscal deficit which is driven by higher levels of debt servicing. Thus, successive governments both military and civilian has made little or no efforts at reducing the burden of debt, that is why debt servicing takes a larger chunk of the country's income. With the exception of Obasanjo administration, who was able to secure debt forgiveness though it has grown in thousands fold back The question then becomes why has external borrowing not accelerated the pace of growth and development of Nigerian economy as applicable in some developing Nations.

Facts emerging from the Debt Management Office(DMO 2022) revealed that both external and domestic debt stood at #42.84 trillion (USD 103.31 billion) by June, 2022. Total external debt stock was USD 40.06 billion (#16.61 trillion) by March, while over 58% of external debt stock are concessional and semi concessional loans. Total domestic debt stock was #26.23 trillion and total public debt to GDP ratio as at June 30 was 23.06% compared to 23.27% in March. Nigeria total public debt to GDP as at June 2022 was 23.06%, although, the ratio has not been stable over the years, 27.69% and 29.17% for 2018 & 2019 respectively. But it rose to a high level of 34.9% & 36.63% in 2020 and 2021.

Also, the total government debt for the country stood at 103312.80USD million in the second quarter of 2022 from 100069.89 USD million in the first quarter of

2022. DMO(2022). Premium Times(2022) reports that Nigeria public debt rose to #41.6 trillion from #39.56 trillion recorded in 2021, December, putting serious pressure on debt servicing. Again, nigeria fiscal position worsened as the cost of debt servicing surpased government revenue in the first quarter of 2022. The details looks worrisome because while total revenue was #1.63 trillion, debt servicing was 31.94 trillion with a variance of #300 billion.

The study aimed to investigate the effect of foreign debt on economic development in Nigeria from 1986 to 2021 and establish the direction of causality between external debt and economic development. The study will educate readers by revealing to them one of the major reason why Nigerian economy is growing at a very slow rate despite the frequent and huge borrowing by various government at all levels over the years and to guide on steps to take in curtailing the total outstanding foreign debt.

Literature Review

Conceptual Review

Foreign debt, also known as external debts are funds sourced from outside the nation's boarder usually in foreign currency and are interest-bearing to finance specific project(s) and it has to be paid back in the same currency which it was borrowed. It could be obtain from International Financial Institutions like International Monetary fund (IMF), International Bank for reconstruction and Development (IBRD), African Development Bank(AfDB), Asian Development Bank(ADB), government and Banks of foreign Nations(economictimes,2022). Also, external debts are funds sourced from outside the nation's boarder usually in foreign currency and are interest- bearing to finance specific project(s). On the other hand, Todaro& Smith (2019) defined development as a multidimensional process involving major changes in social structures, popular attitudes and national institutions, as well as the acceleration of economic growth, the reduction of inequality and the eradication of poverty. According to the Society for International Development(SID,2022), development is a process that created growth, positive change or the addition of physical, economic, environmental, social and demographic components.

[13]*Empirical Reviews*[+5]

Francisco, Rafael and Jose (2018) investigated the impact of public debt on economic growth, evidence of correlation between public debt and economic development in Mexico and thus the study concluded that public debt should be channelled to productive sector of the economic for maximum and sustatiananle economic

development. Sami & Mbah (2018) elucubrate the nexus between external borrowing and economic growth, prompted by continuous increases in Oman's foreign debts to finance her annual budgets. Adopting the ARDL approach, the result revealed that a negative and significant impact of external debts on economic growth. Gross fixed capital exerted positive and significant impact in the determining growth performances.

Senadza, Fiagbe & Quartey(2018) examined the impact of external debt on economic growth in sub-Saharan African countries in view of an upsurge in the level of external debt in different countries in the region. Adopting the system GMM from 1990 to 2013, their findings showed that external debt negatively affects economic growth, hence the need to ensure that foreign debt are invested properly to generate enough returns to amortize the debt. Cordelia & Oyechi (2019) studied the impact of foreign debts on economic growth in Nigeria from 1997 to 2017 adopting OLS techniques for their analysis, the results of the study showed that foreign debts exert a significant negative influence on economic growth.

Lerato(2019) viewed borrowing as not really an issue but the most unfortunate part of it, is that sub-Saharan African countries including South Africa have accumulated high and unsustainable amount of debts which has hampered their pace of economic growth and development. The study adopted ARDL model to examines the nexus between foreign debts and government debts on economic growth in South Africa and finds out that sound debts management can spur economic prosperity. Mehdija (2020) carried out a comparative analysis of the impact of debt on economic development in Western Balkan countries using disaggregated level data sourced from international debt instituted and world development indicatos. Findings revealed that external debt has positive and significant impact on eonomic development.

Badreldin, Abderhim, Hamza and Tarig (2020) examined the significant effect of external debt on economic development and the results showed that the economical help seems to be a necessity of the time while due to its adverse effects in case of excessive use, there must be the strategies and pre-planning for utilizing and returning the debt. Ekpe(2020) studied the influence of external debt on economic growth in Nigeria, employing ARDL method, bonds tests and granger causality test, results revealed that external debt assumes a positive and insignificant relationship with GDP.

Siti (2020) in his study addresses the role of institutional quality in the nexus of external debt and economic growth. Findings showed that, institutional quality plays some role in complementing the effects of external debt on a country's economic growth. Ly (2021) looked at the dependence pattern of economic growth on external debts supply by accounting for the safety of debts, measured by the sovereign debt rating from 1990 to 2019. Findings from the study revealed that, economic growth

followed a U-shaped curve and for low supply of external debts, a higher supply of debts reduces the debt rating which in turn lowers the economic growth rate.

Efanga, Etim and Jeremiah (2021) used ARDL model to examained the significant impact of public debt on economic development in Nigeria using secondary data between 1981 and 2016 and concludes that public debt has positive and significant impact on economic development in Nigeria. Ideh & Uzonwame (2021) looked at the impact of external debt on economic growth in Nigeria, following the incresing spate of Nigeria' s debt profile and the fluctuating trend in her macroeconomic indicators. The result showed that external debt has negative insignificant impact on economic growth.

Abdulkarim, Saidatulakmai & David(2021) studied the impact of government debt on Nigeria's economic growth, with annual data from 1980 to 2018 using ARDL techniques. Findings from their result showed that external debt retarted long-term economic growth but its short-run impact was growth-enhancing.

2.3. Theoretical Framework

The Keynesian Theory

The Keynesian school of thought view external debt as the best policy that stimulates growth and development of the economy as its acts on the interest of the general public. According to Keynes, when the government embarks on borrowings to finance its expenditure, unemployed funds are withdrawn from the private leaving personal consumption unaffected. The injection of these funds back to the economy stimulates investment through infrastructural development, multiple increases in aggregate demand thus, resulting to increase in output and employment. Keynes believed that when the government embark on public borrowing to finance her expenditure, unemployed funds are withdrawn from the private pockets, such that the consumption level of private individuals remains unaffected. These funds when injected back into the economy by the government leads to a multiple increase in aggregate demand causing an increase in output and employment.

Hence, public borrowing can be used to influence macroeconomic performance of the economy. On the other hand, the indirect effect of public borrowing has its effect on investment. The transmission mechanism through which debts affect growth is its reduction on the resources available for investment by debt servicing. Also, public debt can act as an implicit tax on the resources generated by a country and create a burden on future generations which come in the form of a reduced flow of income from a lower stock of private capital. This in turn, may lead to an increase in long-term interest rates, a crowding out of private investments necessary for productivity growth, and a reduction in capital accumulation.

According to Keynes, it is called the multiplier effect of government expenditure. Mathematically;

$$\Delta Y = K\Delta G$$

Where; ΔY means change that occurred in development, resulting from changes in government expenditure, holding all other exogenous variables constant while ΔG means change in government expenditure (expansionary monetary and fiscal policy through borrowing) and K is the multiplier

$$\text{Where } K = \frac{\Delta Y}{\Delta G} \qquad \text{ii}$$

Equation ii indicated that change in overall economic output divided by change in government expenditure is equal to multiplier. This shows that increase in borrowing to augment deficit budget influences macroeconomic performance and social system in the economy.

3. Model Specification

The study adopted the model of Matthew and Mordecai (2016) with little modification to suit the purpose of this study. The variables included in the model are based on the theoretical and empirical literature.

$$lnRPCI_t = \beta_0 + \beta_1 lnTED_t + \beta_2 lnEDS_t + \beta_3 lnEXP_t + \beta_4 lnFDI_t + \beta_5 lnGFCF_t + \varepsilon_t \qquad \text{iii}$$

Where RPCI = Real per capita income, TED = total external debt stock, EDS = external debt servicing, FDI = Foreign direct investment inflows, GFCF = Gross Fixed capital formation EXP = government expenditure and ε = *stochastic error term* and t is the time trend

Results and Discussion

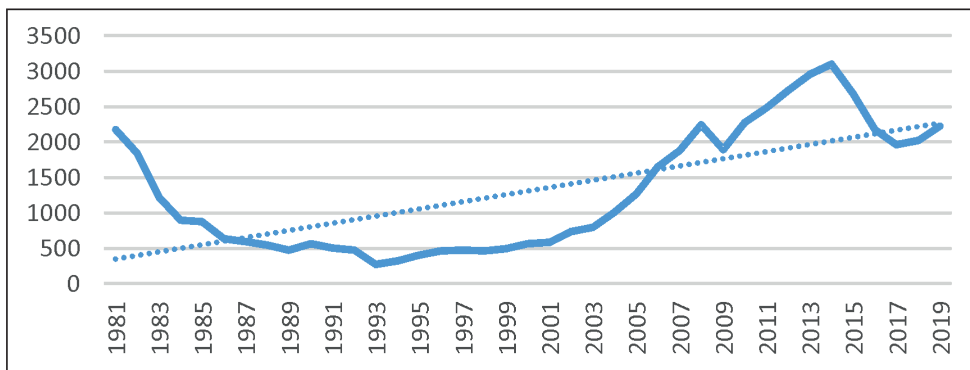

Figure 1: Trends of Real Per capita Income.

Source: Author's Computation, 2023

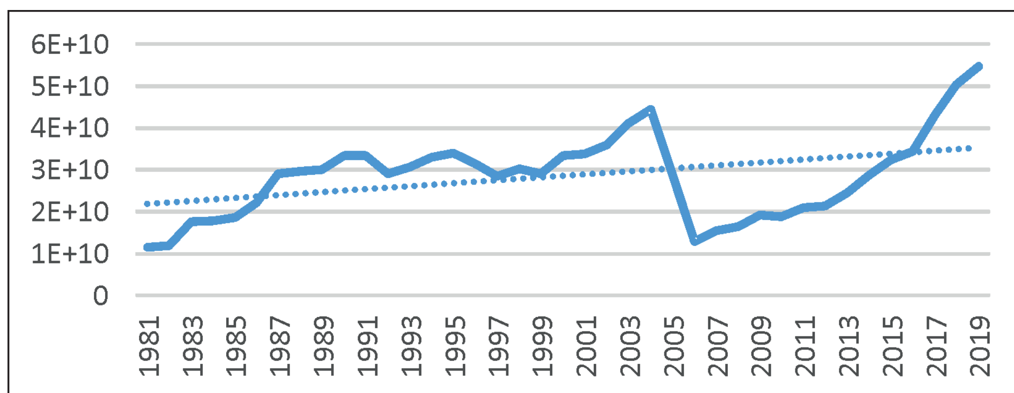

Figure 2: Trends of External Debt.

Source: Author's Computation, 2023.

Figures 1 and 2 show that the real per capita income and external debt has exhibited an upward linear trend. The upward linear trend exhibited by the two variables might be due to various government and the Central Bank of Nigeria's policies (monetary and fiscal) aimed at facilitating sustainable economic development in Nigeria. The upward trend in foreign debt can be attributed to the continuous increase by different government at all levels accessing foreign loans. This trend continued over the years and servicing all these debts over the years has really constitute a serious threat to the growth and development of the country.

Table 1: Results of Augmented Dickey-Fuller Unit Root Test

Variable	*ADF Test Statistic at level*	*MacKinnon Critical Value at Level at 5percent level*	*ADF Test Statistic at first Difference*	*Mac-Kinnon Critical Value at First Difference at 5percent level*	*Decision*
RPCI	-0.779671	-2.945842	-4.227462**	-2.948404	I(1)
TED	-2.551989	-2.945842	-4.609978**	-2.948404	I(1)
EDS	-3.758460**	-2.945842	N/A	N/A	I(0)
FDI	-1.950581	-2.945842	-9.859250**	-2.948404	I(1)
GFCF	-1.525409	-2.945842	-3.18610**	-2.948404	1(1)
EXP.	-0.283103	-2.945842	-5.509155**	-2.948404	1(1)

Source: Author's computation, 2023. **significant at 5% level

Table 1 shows that only foreign debt variable is stationary at level. Thus, we conclude that variables (RPCI, TED, FDI, GFCF, and EXP) under investigation are integrated of order one (I (1)) while variable (EDS) is integrated of order zero (I (1)) and as such F Bound Test was conducted.

Table 2: Result of the Bounds Test

Panel A		
Test Statistic	Value	K
F-statistic	17.87229	5
Panel B	Pesaran *et al.* (2001) critical values	
Critical Value Bounds	I (0)	I (1)
(at 5% Significance Level)	2.39	3.38

Source: Author's computation, 2023

From table 2, it can be inferred that there is co-integration (long run relationship) between the variables as the value of the F-statistic is greater than the upper bound of the 5% Pesaran critical value. Therefore, we reject the null hypothesis and conclude that there is long run relationship between the independent variables (external debt, debt servicing, foreign direct investment, gross fixed capital formation and government expenditure) and the real GDP per capital income (dependent variable).

Table 3: Result of long run ARDL estimation for the model

Dependent Variable: D(LNRCPI) Method: ARDL Proxy for EXTERNAL DEBT: LNED			
Variable	*Coefficient*	*t-Statistic*	*Prob.*
D (LNRPCI (-1))	-0.026065	-0.246651	0.8069
D(LNED)	-0.098829	-0.949489	0.3500
D(LNDS)	0.002358	0.090013	0.9289
D(LNFDI)	-0.002947	-0.111170	0.9122
D(LNGFCF)	0.608697**	6.084917	0.0000
D(LNEXP)	0.122379**	2.548414	0.0162
C	0.001722	0.211798	0.8337
LNRPCI (-1)	0.589010**	4.465702	0.0001
LNED	-0.085431	-1.492847	0.1459
LNDS	-0.008640	-0.319691	0.7514
LNFDI	-0.001683	-0.059419	0.9530
LNGFCF	0.634279**	6.301083	0.0000
LNGFCF (-1)	-0.466598**	-3.427243	0.0018
LNEXP	0.116471**	2.904810	0.0068
C	-0.663486	-0.465586	0.6449
R-squared	0.986622	F-statistic	316.0768
Adjusted R-squared	0.983501	Prob. (F-statistic)	0.000000
Durbin-Watson Stat:	1.789246		
Breusch-Godfrey Serial Correlation LM:	0.252975	Prob.(F-statistic)	0.6188

Source: Author's computation,2022 **indicates 5% level of significance

From the result in table 3 and 4, the estimated model shows that foreign debt has an insignificant negative effect on economic development in Nigeria both in the long and short run for the period under review at 5 % and 1 % respectively. 1 % increase in foreign debt will leads to 0.099 % decrease in real per capita income. The coefficient of debt servicing (LNDS) shows that it has an insignificant negative effect on economic development in Nigeria in the short run. This implies that one percent increase in debt servicing will induce 0.08 percent decrease in real per capita income.

Gross fixed capital formation and government expenditure exert significant positive effect on economic development both in short run and long run. 1 % change in gross fixed capital formation induces 0.61% and 0.63 % changes in economic development in short run and long run respectively. While a 1% change in government expenditure will exert 0.12 % change in both long run and short run. The coefficient of determination (R^2) and its adjusted R^2 are 0.98 and 0.98 respectively implying that there exists goodness of fit in the model. This means that about 98 % of the variation in economic development is accounted for by variation in foreign debt, debt servicing, foreign direct investment, gross fixed capital formation and government expenditure. The overall regression (F-Test) is significant at 5 % level of significance implying that the joint effects of all the included variables were significant. The Durbin Watson statistic of 1.79 shows evidence of no autocorrelation in the model since it is approximately within the range of 2. The results show absence of serial correlation.

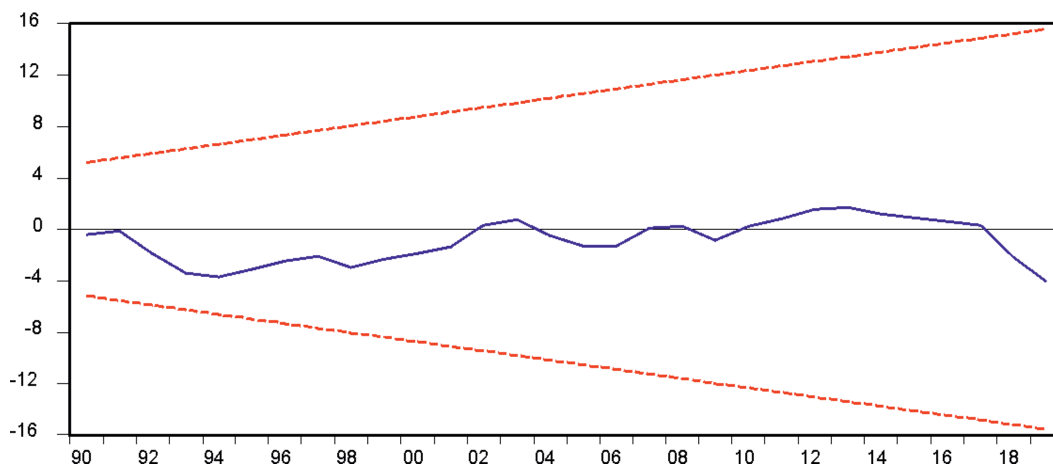

Figure 3: Plot of Cumulative Sum of Recursive Residuals of the model

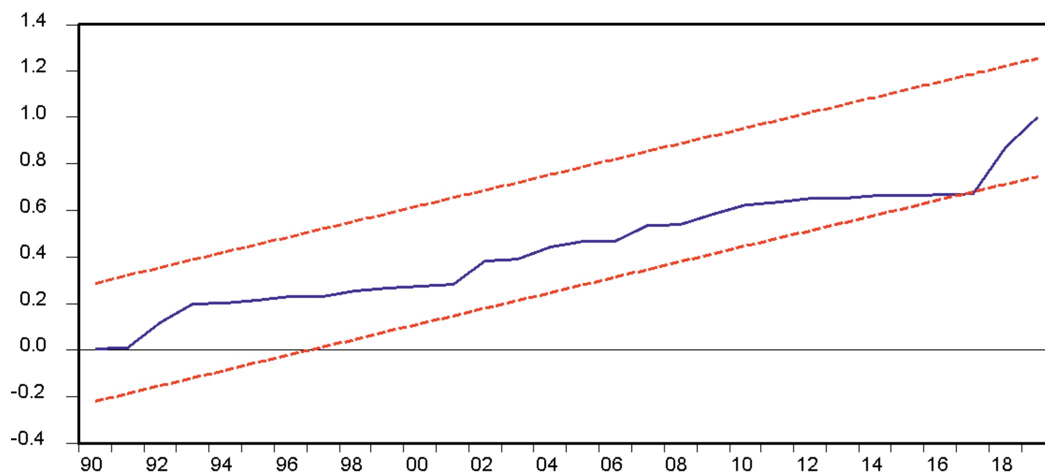

Figure 4; Plot of Cumulative Sum of Squares of Recursive Residuals of the model
Source: Authors computation 2023

Figure 3 & 4 show that the model is stable using the cumulative sum of recursive and cumulative sum of square of recursive test.

Table 5: Result of the restricted error correction model

Dependent Variable: D(LNRPCI) Method: ARDL Proxy for EXTERNAL DEBT: LNED				
Variable		*Coefficient*	*t-Statistic*	*Prob.*
ECT (-1) **		-1.026065**	-12.25264	0.0000
R-squared		0.806386	F-statistic	14.23750
Adjusted R-squared		0.806386	Prob (F-statistic)	0.000000
Durbin-Watson Stat:		1.861427	-3.907498*	0.0011

Source: Author's Computation 2023

The error-correction term (ECT) provides further direct evidence on the long-run co-integration dynamics that exist between Real per capita income and its regressors in the model. The error correction coefficient is estimated to be -1.026065, which is reasonably large (and highly significant). This suggests that any departure from the long run equilibrium is corrected at the rate of 102.6 percent. This means that the speed of adjustment is very high and departure from long run equilibrium will be fully corrected in less than one year.

Conclusion

The study examined the effect of foreign debt on economic development in Nigeria between 1981 and 2019 using the ARDL technique and the result revealed that

foreign debt has negative effect on the economic development both in the short and long run (which is similar to the study of Mattew &Mordecai (2016) and Elom-Obed,Odo,Elom, & Anoke(2017) but government expenditure, fixed capital formation and foreign direct investment inflow impacted on economic development positively. The result shows that the overall regression is significant at 5% level of significance using the F-statistics. There is about 98% of variation in economic development which is accounted for by variation in external debt, debt servicing, foreign direct investment, gross fixed capital formation and government consumption expenditure. The speed of adjustment of disequilibrium was also tested and it was seen that it will take less than one year for any disequilibrium to adjust to an equilibrium state.

It is generally believed that foreign debt is an important factor that a country needs to escape vicious cycle of poverty. This study also confirmed that foreign debt contributes in a negative way to economic development in Nigeria. 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 times almost to the tune of the capital), then repayment becomes a problem and such debt will become a bad debt, no wonder, most developing countries groan under the burden of both foreign and domestic debts. The study e discovered that foreign debt have insignificant negative effect on economic development which is mostly caused by poor debt management strategies, corruption, and abandonment of projects among other reasons. Gross fixed capital formation and government expenditure were also found to have significant positive effect on economic development hence; the study concludes that increased government expenditure will enhance economic development but not from those sourced from foreign land.

Since foreign debt negatively impact economic development as evident from findings, the modalities of incurring external debt and their application should be technically and tactically analyzed prior to accessing the debt. However, debts in the first year of receipts tend to have a negative impact on the Nigerian economy. The study revealed that foreign borrowing slow down economic development, therefore government should ensure proper utilization of external funds. Also, government should ensure prompt payment of debt services to avoid accumulating more debt. Since government expenditure inhibit economic growth, government should reconsider her spending structure to favour infrastructure development which would motivate both local and foreign investors to invest and in turn enhance economic development and ensure that external debts incurred are channel towards productive uses.

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