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AN ECONOMETRICS ANALYSIS OF THE NEXUS BETWEEN EXTERNAL DEBT SERVICE AND ECONOMIC GROWTH IN NIGERIA

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ABSTRACT

This study examines the effect of external debt service on economic growth of Nigeria. For a developing country like Nigeria that is faced with scarcity of capital to grow economically, there is the need to borrow abroad to supplement domestic savings. Nigeria has been experiencing manifestation of the adverse effects of external debts which are low capacity utilization which results to low production, backward technology, high and chronic unemployment rate, high dependence on oil production and export of primary products which has led to decrease in economic growth over the years. In view of this, the study is aimed at assessing the effects of external debt on economic growth of Nigeria. The study also examines external debt trend of Nigeria and the effect of macroeconomic variables on external debt in Nigeria. The study relied on time series data which was gathered from CBNstatistical bulletin. Co-integration test and error correction model were used as the estimation technique. The study showed thatincrease in external debt has a drastic negative effect on Gross Domestic Product (GDP) and that increase in external debt can discourage private investment and alsomacroeconomic variables can lead to external debt. The study recommended among others that the economic reform must target macro-economic stability, removal of structural distortions and creation of conducive environment for enhancing domestic production capacity.

Key words: *External Debt Service, Economic Growth, Capacity Utilization, macroeconomic variables, Gross Domestic Product.*

1. INTRODUCTION

It is a well-known fact that Nigeria is faced with high level of Indebtedness (relative to her Gross Domestic Product). This issue has gained much attention during the recent decades as Nigeria has experienced lasting budget deficits which led to sharp increases in debt-to-GDP ratios, and a large share of external debt. External debt is defined as all external obligations of a maturity of one year or more and outstanding at a particular point in time and are payable in terms of reserves currency or goods and services. All countries have passed through different stages in their financial and economic history. They all started as net borrowers, became mature borrower, and then they occupied the position of new creditors.

According to Malik, Hayat & Hayat (2010), external debt was considered a significant source of income for developing countries. From the late 1950's, current account deficit was considered normal. The countries facing current account deficit were encouraged to borrow from international community to boost their economic growth. In addition, external debt is a major source of public receipts. The accumulation of external debt should not signify slow economic growth. It is a country's inability to meet its debt obligation compounded by the lack of information on the nature, structure and magnitude of external debt that led to the problem of external debt burden (Were, 2001). In same vein, Gana, (2002) posits that foreign borrowing is desirable and necessary to accelerate economic growth, provided they are channeled to increase the productive capacity of the economy and promote economic growth and development.

During the last fifty years, the external debt problem is one of the main challenges faced by the developing countries like Nigeria. External debt and its repayments act has hindered the economic growth and development of developing countries. In the past three decades it has been observed that external debt has been the main cause of decline in investment and the growth performance of many nations. This external debt is like an unfavorable tax on future generations, which they have to pay for nothing. (Omoleye, Sharma, Ngussam, & Ezeonu (2006)), Nigeria is the largest debtor nation in the Sub-Saharan Africa. The genesis of the country external debt can be traced to 1958 when 28 million US dollars was contracted from the World Bank for railway construction.

The first major borrowing of 1billion US dollars referred to as Jumbo loan was contracted from the international capital market (ICM) in 1978 increasing the total to 2.2 billion U.S dollars (Adesola, 2009). The spate of borrowing increased thereafter with the entry of the state government into external loan contractual obligation. According to the Debt Management Office (DMO), Nigeria's external debt outstanding stood at N17.3 billion. In 1986, Nigeria had to adopt a World Bank/International Monetary Fund (IMF) sponsored Structural Adjustment Programme (SAP), with a view to revamping the economy making the country better-able to service her debt (Ayadi & Ayadi, 2008). More so, the increasing fiscal deficits driven by the higher level of external debt servicing is a major threat to growth of the nation. The resultant effect of large accumulation of debt exposes the country to high debt burden. Nigeria is about the richest on the continent of Africa, yet due to the

numerous macro-economic problems, such as inflation, unemployment, sole dependency on crude oil as a major source of revenue, corruption and mounting external debt and debt service payment; majority of her citizen fall below the poverty line.

From the submission of Soludo (2003), he opined that countries borrow for two broad categories; macroeconomic reasons to either finance higher investment or higher consumption and to circumvent hard budget constraint. This implies that an economy borrows to boost economic growth and alleviate poverty. He argued that when debt reaches a certain level, it becomes to have adverse effect, debt servicing becomes a huge burden and countries find themselves on the wrong side of the debt-laffer curve, with debt crowding out investment and growth. The debt service burden has militated against Nigeria's rapid economic development and worsened the social problems (Audu, 2004).

Nigeria, as a mono-product economy, found itself in this position in the 1980s when her external debt positioned worsened. As a result of this, Nigeria was unable to generate sufficient revenue from the sale of her crude oil to service the debt owed international creditors. However, various strategies were tried in mitigating the effects of the huge debt burden. These include internal embargoes and limits on new loans, rescheduling, restructuring, debt servicing and plea for debt forgiveness. These strategies did not appear effective and the economy failed to achieve the desired rate of economic growth. Thus, the rapid growth of external debt stock and debt service payments became clogs on the wheel of national economic growth effort (Ezeabasili, 2006).

The origin of Nigeria's external debts dates back to 1958 when a sum of US $28 million was contracted for railway construction. Between 1958 and 1977, the level of foreign debt was minimal, as debt contracted during the period were the conventional debts from bilateral and multilateral sources with longer repayment periods and lower interest rates constituting about 78.5 percent of the total debt stock. From1978, following the collapse of oil prices, which exerted considerable pressure on government finances, it became necessary to borrow for balance of payments support and project financing. This led to the promulgation of Degree No 30 of 1978 limiting the external loans the federal government could raise to 5 billion Naira. The first major borrowing of US $1 billion referred to as jumbo loan was contracted from the international capital market (ICM) in 1978 increasing the total debt to US $2.2 billion. Thereafter, the spate of borrowing increased with the entry of state governments into external loan contractual obligations. While the share of loans from bilateral and multilateral sources decline substantially borrowing from private sources also increased considerably. Thus by 1982, the total external debt stock was US$13.1 billion. Nigeria's inability to settle her import bills resulted in the accumulation of trade areas amounting to US $9.8 billion, between 1983 and 1988 (Iyoha, 2000).

The total debt outstanding at the end of 1999 was US $28.0 billion with Paris club constituting the highest source with a share of 73.2 percent in 1999 prior to the canvass made for debt cancellation. Contrary to the illusory- image of "oil-rich" country, Nigeria is a heartily indebted poor country. Its total external debt stock, as at

December 2000, is estimated by the Nigerian government at about $28.3 billion, it includes arrears amounting to $14.7 billion and late interest of over $5 billion. A significant proportion of this debt (75%) is owed to official creditors. The bulk of Nigeria's debt was incurred at non confessional terms during the late 1970s and early 1980s, during a period of significantly low interest rate regime when the London inter Bank offered Rate (LIBOR) hovered between 3% and 4%. The debt grew rapidly through the eighties due to accumulation of debt service arrears and escalation of market interest rate. LIBOR peaked at 13% in mid 1989 (Iyoha 2000).

As a result, the pre-1984 debt of most developing countries, Nigeria inclusive quadrupled by 1990. The collapse in oil price compounded by poor economic policies, bad management and unfavourable loan terms, made it externally difficult to service the mounting external debt obligation, particularly those due to the Paris club. Hence despite the rescheduling in 1986, 1989 and 1991 arrears continue to amount, which further worsened the debt problem.

As at December 2000, Nigeria's debt stock amounted to about 75 percent of GDP and about 180 percent of export earnings. Debt service due in 2000 was about US $3.0 billion or 14.5 percent export of export earnings. In 1999, for example spending on health represented about 0.2% of GDP and 0.7 percent of GDP compared with 3.4 percent (US $1.5 billion) annual budget spent on debt servicing during the same period. In 2000, US $1.9 billion was used for debt servicing translating to about 4 times federal Government budgetary allocation to education and about 12 times the allocation to health while in 2001 debt service payment was US $2.13 billion which amounted to 6 times of the Federal Government's budgetary allocation to education and 17 times allocation to health for that year. This problem can be better understood if the resources committed to debt services as listed above are related to national output. Thus, this research is necessary at this point, when new loans are being negotiated from the world bank and other countries (Soludo 2003).

Sachs (1990) was of the view that the external debt overhang is a main root cause of economic slowdown. The author argued that the external debt is a symptom of bad economic management and performance and it's not a primary cause of economic growth. Fosu (1999) argues that even if the debt has little impact on the rate of investment it is possible that external debt adversely impacts on economic growth through declining the productivity of capital. Were (2001) states that external debt stock has a negative impact on economic growth, Essien & Onwioduokit (1998) examine the impact of foreign debt on economic growth and they found that the degree of responsiveness of growth to external finance in Nigeria is elastic. By implication government should only put in place appropriate debt management strategies to enhance economic growth. They tried to test the impact of federal government's debt on economic growth and examine if the optimal debt ratio exists that will maximize growth. The debt/GDP ratio corresponding to the maximum GDP growth rate was found to be 38.4%. The results show that during 1980s and early 1990s, federal debt has a different role in economic growth. In the early 1980s, debt ratio rose but it was below 38.4, thus debt-financing stimulates economic growth.

In a more recent Study, Ezeabasili, Isu & Mojekwu (2011) investigates the relationship between Nigeria's external debt and economic growth between 1975 and 2006. Econometricevidence revealed stationarity at the variables of their first difference while the Johanson co-integration approach also confirms the existence of one co-integrating relationship at the 1 percent and 5 percent level of significance. Also, error correction estimates revealed that external debt has negative relationship with economic growth in Nigeria.

In the same vein, Ajayi&Oke (2012) investigates the effect of the external debt burden on economic growth and development of Nigeria. The study adopted regression analysis of OLS on secondary data. Some variables of interest used in the study are; National Income, Debt services payment, External Resources, Interest rate among others. The findings indicates that external debt burden had an adverse effect on the nation income and per capita income of the nation. Also that high level of external debt led to devaluation of the nation currency, increase in retrenchment of workers, continuous industrial strike and poor educational system.

In a slightly different manner, Faraji & Said (2013) investigates the impact of external debt on economic growth of Tanzania for the periods of 1990- 2010. The study used time series data on external debt and economic performance. The study revealed that there is significant impact of the external debt and debt services on GDP growth. The total external debt stock has a positive effect of about 0.036939 and co-integration test shows that there is no long run relationship of the external debt and GDP. Abdullahi, Allero & Abdullahi (2013), analyses the relationship between external debt and economic growth in Nigeria, Using true series data for the period 1970-2009. The study adopted the co-intergation techniques. The result of the test showed a long run relationship between real GDP and external debt as well as government expenditure. However, the Granger causality test results showed that, there is no short run relationship between external debt and economic growth in Nigeria. The study conclude that the non-existence of long run relationship between external debt and economic growth in Nigeria indicates that increase in external debt could result to decrease in GDP

Ademola, Olaleye, Ajayi & Babatunde (2013) empirically examined the impact of external debt on sustainable economic growth with particular emphasis on Nigeria between 1980-2010. The results suggest that 12.3% changes in economic growth is causedby external debt and prime lending rate. A more recent work by Balago (2014) examines whether or not a relationship exists between external debts and economic growth in Nigeria. The result showed that external debt has a fairly significant positive relationship with the Gross Domestic Product (GDP).

Many studies have attempted to investigate the relationship between external debt and economic growth. Some of these studies included Greene & Villeneva (1991), Desphande (1997), Iyoha (2000), Sachs (1990), Fosu (1999), Essien & Onwoduokit (1998) and were (2001)Ezeabasili*et al* (2011), Ajayi & Oke (2012), Faraji & Said (2013), Abdullahi*et al* (2013) and Balago (2014). However, most of these studies were done in environments different from that of Nigeria. The few authors from Nigeria who have delved into the relationship between external debt and

economic growth, based their studies on the use of Ordinary least Square Techniques which ignored the possibility of changes that might have taken place over time.

Again, the time frame considered in these studies was short and their results were conflicting and inconclusive, thereby creating a knowledge gap which this study intends to fill. This therefore, warranted a more systematic and comprehensive study of the relationship between external debt and Nigeria's economic growth and the possibility of the country achieving her vision 20:2020 by determining how external debts affect the growth of the country, the effectiveness of different debt servicing measures that have been adopted and evaluate the crowding out effects of external debts in Nigerian economy.

2. METHODS

Data and Sources

Given the design of this study, secondary data were sourced for the study. Data on real gross domestic product, external debt service, foreign direct investment, trade balance, exchange rate and interest rate were sourced from the Nigerian Statistical Fact Sheets on Economic and Social Development, National Bureau of Statistics, Various Issues and CBN Statistical Bulletin 2015 edition respectively.

Model Specification and Estimation Techniques

The model for this study follows the work of Ayadi and Ayadi (2008) where economic growth is modeled as a function of population increase, technical progress, gross private investment and external debts services. The model for the study is therefore specified as follows with little modification.

RGDP = F (EDS, FDI, TDB, EXR, INTR)

The econometric form is

$$RGDP = \propto_0 + \propto_1 EDS + \propto_2 FDI + \propto_3 TDB + \propto_4 EXR + \propto_5 INTR + \mu_t$$

Variables Definition

RGDP - Real Gross Domestic Product (proxy for economic growth in Nigeria)

EDS - External Debts Service

FDI - Foreign Direct Investment inflow into the Nigeria economy

TDB - Trade balance

EXR - Exchange rate

INTR - Interest rate

μ_t - Stochastic term

$\propto_1 - \propto_5$ - Parameters to be estimated

The analytical procedure adopted in this study is discussed below and these include, testing of unit root, cointegration and error–correction modeling.

Unit Root Test – if time series data are non stationary then the regression results based on the ordinary least squares (OLS) method will be spurious. Therefore, there is

a need to test whether the time series variable is stationary or not. The unit root test provides the information about the stationarity of the time series variables. If the time series variable is not stationary, then the series contain unit root. The presence of unit root in the time series data generates unreliable results regarding the hypothesis testing. It is usually carried out before testing the long-run relationship (cointegration). The ADF test was used to test for the unit root.

Cointegration-two or more variables are said to be cointegrated, meaning that they exhibit long-run equilibrium relationship, if they share common trend. The pioneering work by Engle and Granger (1987), on the cointegration technique identified the existence of a integrating relationship as the basis for causality.

Error Correction Model

The presence of co integration between the variables makes it possible to investigate the short run relationship between RGDP, EDS, FDI, TDB, EXR, INTR. An error correction modeling helps to examine the presence of equilibrium or disequilibrium between short run dynamics and long run equilibrium. The estimate of negative error correction term in ECM explains the extent of disequilibrium that can be eliminated at each period.

3. RESULTS AND DISCUSSION OF FINDINGS

Unit Root Table

Table 1 Unit Root Test at Level

Variables	ADF test statistic	Test critical values	Remarks
LTDB	-0.653656	-3.689194	Not integrated at level
LRGDP	0.023495	-3.670170	Not integrated at level
LFDI	-0.900237	-3.679322	Not integrated at level
LEXR	-1.482327	-3.670170	Not integrated at level
LEDS	-0.954595	-3.670170	Not integrated at level
LINTR	-2.156670	-3.699871	Not integrated at level

Source: Author's Computation

TABLE 2 Unit Root Test at First Difference

Variables	ADF test statistic	Test critical values	Remarks
LTDB	-5.894803	-3.689194	I(1)
LRGDP	-4.415581	-3.679322	I(1)
LFDI	-8.125888	-3.679322	I(1)
LEXR	-4.738612	-3.679322	I(1)
LEDS	-3.860917	-3.679322	I(1)
LINTR	-5.333179	-3.679322	I(1)

Source: Author's Computation

It is known fact that most times series data are non-stationary and in order to avoid the devastating effect of spurious regression and reduce the tendency of false results, unit root test was carried out with an intention of determine the stationarity condition of the variables. Using the Augmented Dickey Fuller(ADF) test at both level and first difference , we discovered that the six variables in natural logarithm namely :natural logarithms of real gross domestics product (LRGDP) , natural logarithms of trade balance(LTDB) , natural logarithms of foreign direct investment(LFDI) , natural logarithms of exchange rate (LEXR), natural logarithms of external debt service(LEDS) and natural logarithms of interest rate(LINTR) possessed unit root at level , this implies that the variables are not stationary at level, this prompted us to carried out the test at first difference .The variables rejected the hypothesis of unit root at first difference , thus , they are stationary at first difference . In order to determine the long run equilibrium of the variables, we adopted both Jahansen and Engle and Granger residual test (table,3), the two tests indicates that there exist long run equilibrium and the variables will tend to converge in the long run judging by the stationarity condition of the residual at level and the trace statistics of the Johansen cointegration test (table 4)

Table 3 Engle and Granger Residual Test

Variables	ADF test statistic	Test critical values	Remarks
ECT	-4.435428	-3.670170	I(0)

Source: Author's Computation

TABLE 4 Johansen Cointegration Test

Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.857962	135.3284	95.75366	0.0000
At most 1 *	0.636461	78.73031	69.81889	0.0082
At most 2 *	0.565200	49.38608	47.85613	0.0356

Source: Author's Computation

Trace test indicates 3 cointegrating equation at the 0.05 level *denotes rejection of the hypothesis at the 0.05

TABLE 5: Overparametized Error Correction Model (ECM).

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.164117	0.052946	3.099736	0.0073
D(LRGDP(-1))	0.745536	0.199735	3.732630	0.0020
D(LRGDP(-2))	0.248970	0.190202	1.308979	0.2102
D(LEDS(-1))	-0.141940	0.048655	-2.917273	0.0106
D(LEDS(-2))	-0.080739	0.054132	-1.491524	0.1566

D(LEDS(-3))	-0.158018	0.037877	-4.171845	0.0008
D(LFDI(-1))	-0.158723	0.058356	-2.719910	0.0158
D(LTDB(-1))	-0.108720	0.036260	-2.998360	0.0090
D(LEXR(-2))	-0.195890	0.098886	-1.980963	0.0662
D(LINTR(-1))	-0.599056	0.158704	-3.774687	0.0018
D(LINTR(-2))	-0.165964	0.196964	-0.842611	0.4127
ECT(-1)	-0.810461	0.166569	-4.865623	0.0002

Source: Author's Computation

Table 6:

R-squared	0.775460	Mean dependent var	0.233697
Adjusted R-squared	0.610797	S.D. dependent var	0.176973
S.E. of regression	0.110407	Akaike info criterion	-1.268190
Sum squared reside	0.182845	Schwarz criterion	-0.692262
Log likelihood	29.12056	Hannan-Quinn criter.	-1.096936
F-statistic	4.709376	Durbin-Watson stat	1.903676
Prob(F-statistic)	0.003315		

Source: Author's Computation

Interpretation of Results

The overparametized error correction estimate shows that the model will adjust to its long run equilibrium which further confirmed the long- run equilibrium. The coefficient of the error correction term (-0.810461) was appropriate signed and statistically significant at 5 percent level of significance which indicates the speed of adjustment of the model, this implies that the model will converge to its long run equilibrium and more so, about 81.04 percent of the errors or disequilibrium will be corrected in short run in order to achieve the long run convergence.

The adjusted r-square (0.610797) reports that about 61.07 percent of the variation was accounted for by the independent variables, while about 39 percent of the variation in dependent variable were unaccounted for ,which could be attributed to the unnoticed random errors and disturbance shocks. The F-Statistics (4.709376) with P-value of 0.003315 indicates that the model passed the test of significance, which implies that, is statistically significant at 5 percent level of significance.

Furthermore, the one lagged variable of RGDP reports the existence of relationship between the current change in the real gross domestics product and it past. The coefficient of 0.745536 shows , one lagged periodical change in the real gross domestic product will induce about 74.55 percent dynamic change in the current real gross domestics product and judging by its t-statistics (3.732630), the variable is statistically significant at 5 percent level of significance. This is a clear

indication that the one percent change in the real gross domestic product will leads to about 74.55 percent in the real gross domestic product. The model also indicates that external debt service will brings about decrease in the current change in the economic growth , one percent increase in the external debt service will decrease the real gross domestic product by 24.89 percent , thus, external debt induces about 24.89 percent dynamism in the model and its one lagged period contribute significantly to the adjustment process at 5 percent level of significance, while the two-lagged period achieved this at 22 percent level of significance and decrease the growth of the country economy by 14.19 percent , this submission affirmed the assertion of scholars who submitted that external debt is detrimental to the growth of the developing economy due to their in ability to diversified and carried out sound economic reforms that will aid the judicious utilization of the borrowed fund, (Fosu 1999, Iyoha, 2000, Audu, 2004, Ogunmuyiwa, 2011).

Moreover, foreign direct investment unexpectedly induce about 15 percent in the decline of the current growth in RGDP which negated our apriori expectation, this could be attributed to the problem of corruption which may erode the positive contribution of the foreign capital inflow and also the neglect of agricultural sector by the foreign investors which ought to have been the bedrock of our economic development and growth owning to the availability of the required and necessary resources in the country .However, in the case of the exchange rate, it was discovered that the variable induce about 19.58 percent in the process of dynamism and its t-value of 1.9809 shows that it different from zero at 10 percent level of significance, therefore, policy of currency devaluation will tend to favour the development and growth of the country as it was done in China, Japan and other so-called Asian Tigers which devalued their currency in order to encourage exportation and discourage domestic demand for importation, however for this occur a sound policy framework that enhances productivity must be put in place .Similarly, one lagged change in interest rate will contribute about 59.99 percent change in the current RGDP, thus, one percent change in interest rate will brings about 59.99 percent decrease in the real gross domestic product.

4. CONCLUSION REMARKS AND POLICY RECOMMENDATIONS

The dynamics change in the external debt service has negative effect on the economic growth, this is an indication that external debt will decline the productivity of the country resources and brings about the unwanted clog in the wheel of economic growth and development, however, no country can do without external loans and debt which serves as a bridge between the country revenue and expenditure, therefore, debt is a necessary evil which must be well managed in order to contribute to the desired growth and development of the economy, hence anti-corruption drive and efficient allocation of the debt must be highly encouraged .

Similarly, interest rate has negative relationship with the economic growth, which indicates that the economic growth will tend to decline if the interest rate increase, this further lend support to assertion that high interest rate had been the bane

of Nigeria development and growth, which had handicapped the investors and boost the industrialization agenda of the government , in views of this , favourable monetary policy should be put in place in order to reduce the interest rate currently prevailing in the country. Banks are not friendly in the granting of loans in this country, which always comes in high price (interest rate), this act is detrimental to the job creation drive of any government.

Furthermore, foreign direct investment in some economy is the source of capital inflow which aided their development, however, this has never been the case in Nigeria, which has not enjoyed the desired contribution of the investment owing to the inadequate infrastructures and facilities needed to enhance the profitability of investment in the country. In realizing this, concerted effort should be geared toward the development of infrastructures like road, rail, power that will brings about positive contribution of the capital inflow.

Moreover, increase in the exchange rate will lead to the decrease in the economic growth and development, this shows that the devaluation of naira will contribute to the development of this country, through discouragement of import demand and enhances our export drive, which will strengthen the balance of payment and trade.

Consequent upon the findings and conclusions in this study, the following recommendations are made;

The study showed that there is a significant negative relationship between external debt service and economic growth in Nigeria. Since external debt is an inevitable tool in the growth and development of developing countries in which Nigeria is among, government should formulate and implement appropriate monetary and fiscal policies that will ensure external loans are channelled to the provision of critical infrastructures like; power, rail, road etc. In other words, external loans should be made productive and well managed.

Expectedly, the study showed a negative relationship between interest rate and economic growth in Nigeria. The high interest rate had been the bane of economic growth in Nigeria. Hence, government should embarked on radical monetary policies that will make the cost of borrowing (interest rate) affordable in order to further the boost the industrialization drive of the Nigerian government.

Unexpectedly, foreign direct investment had a negative relationship with economic growth which may be reasonably traced to the high level of corruption which might have eroded the foreign capital inflow and the misplaced of priority in the choice of investment by the foreign investors. Hence, government should intensify more effort in the anti-corruption war such that the desired contributions of the foreign capital inflow can be felt in the Nigerian economy.

Finally, the study revealed a negative relationship between exchange rate and economic growth in Nigeria. Therefore, radical policies for currency (naira) devaluation must be put in place in order to strengthen trade balance, enhance export drive as against import demand in Nigeria.

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