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Appraisal of the Effect of External Debt on Economic Growth on Nigeria

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ABSTRACT

The increasing fiscal deficits driven by the higher level of external debt servicing is a major threat to the growth of the nation. The resultant effect of large accumulation of debt exposes the nation 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. Consequently, this study reviewed the effect of Nigeria's external debt on her economic growth. The study concluded that there is a negative impact of debt on the economic growth of Nigeria, and its servicing adversely affects the country even more. Consequently, government should ensure that the acquisition of external debt is largely for economic reason so as to increase the productivity of the nation. Also, there is need to diversify the nation's export base as this will increase export earnings and reduce import dependency.

Keywords: External debt, Economy, Effect, Economic growth, Development.

INTRODUCTION

One major source of aid is foreign borrowing or external debt. The reason for external debt is due to the fact that most developing countries especially, lack sufficient internal financial resources and this result in the need for foreign aid. [1] explained that external borrowing ought to speed up economic growth especially when domestic financial resources are inadequate and need to be supplemented with funds abroad.

The accumulation of external debt ought not to suggest 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 [2]. [3] asserted 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 borrow to boost economic growth and alleviate poverty. He argued that when debt reaches a certain level, it starts 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 [4]. According to [5], Nigeria is the largest debtor nation in the Sub-Saharan Africa. The beginning of Nigeria's external debt can be traced to 1958 when 28 million US dollars was contracted from the World Bank for railway construction. Between 1958 and 1977, the need for external debt was on the low side. However, due to the fall in oil prices in 1978 which exerted a negative influence on government finances, it became necessary to borrow to correct balance of payment difficulties and finance projects. 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 [6]. 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 [7]. The increasing fiscal deficits driven by the higher level of external debt servicing is a major threat to the growth of the nation. The resultant effect of large accumulation of debt exposes the nation 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. Consequently, this study intends to review the effect of Nigeria's external debt on her economy.

Literature Review

Countries experiencing fiscal deficits, especially the developing ones borrow to improve their economic growth. Government borrows in principle to finance public goods that increase welfare and promote economic growth [8]. Due to the fact that the domestic financial resources are not adequate, borrowing is acquired from foreign sources. The amount of fund provided by these foreign sources constitutes the external debt of a nation. In Nigeria, external debt is sourced from multilateral agencies, Paris club creditors, London club creditors, Promissory Note holders and other creditors.

External debt is one of the sources of financing capital formation in any country [9]. External debt is acquired to contribute meaningfully to the economy but the future debt service payment poses a threat to economic growth. A number of researchers have examined the effect of external debt on economic growth since the beginning of the new millennium. [10] 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) methods. Their finding revealed negative impact of debt and its servicing requirement on the economic growth of Nigeria and South Africa. [11] examined whether external debt promotes economic growth in Nigeria using time-series data from 1970-2007. The results revealed that causality does not exist between external debt and economic growth in Nigeria. [12] empirically investigated the effect of external debt service payment practices on the economic growth of Nigeria. Ordinary Least Square method of multiple regression was used to examine how debt payment to multilateral financial creditors, Paris club creditors, London club creditors, Promissory Notes holders and other creditors relates to gross domestic product (GDP) and gross fixed capital formation (GFCF) using data from 1981 to 2004. The study provides evidence that debt payment to Paris club creditors and Promissory Notes holders are positively related to GDP and GFCF while debt payment to London club creditors and other creditors show a negative significant relation to GDP and GFCF. [3] examined the impact of external debt on economic growth and public investment in Nigeria from 1970-2002. The empirical investigation was done using the Co-integration test and Error Correction Method. The study shows that debt servicing pressure in the country has had a significant adverse effect on the growth process, and past debt accumulation negatively affect public investment. [1] analyzed the effects of external debt management on the economic growth of Nigeria for a period between 1962 to 2006 using time-series data of the various bilateral and multi lateral arrangements. Their study

concluded that accumulation of external debt adversely affected Nigeria's economic growth.
Similarly, [6] affirmed that there is a unidirectional and positive casual relationship between foreign debt service and GDP growth after excluding exports revenue growth for Africa and South of Saharan countries during 1983-1990; meanwhile, [2] argued whether indebtedness impacts on the economic activity of developing countries. Accordingly, they observed that if foreign loan are converted into capital and other necessary inputs, development will occur. On the other hand, if borrowing countries misallocate resources or divert them to consumption, the economic development is negatively affected. The study employed the framework of granger. In doing so, six measures of indebtedness were used as proxies for the multiple mechanisms. [10] further showed a striking diversity of experience with growth episode and poverty changes. This became clear in the study carried out by him where it was seen that while some countries over some periods achieved a significant reduction in poverty as the economy grower, others obtain much less appreciable progress. He then concluded that the way in which growth reduces poverty depends on the pattern of growth as well as on the initial inequality of income and assets and its evolution over time. [8] maintained that the external debt situation for a number of low income countries, mostly in Africa has become extremely different. For these countries, even the use of traditional mechanism of rescheduling and debt resection together with continued provision of confessional financing and purist of sound economic policies may not be sufficient to attain sustainable external debt levels within a reasonable period of time and without additional external support. Despite the efforts made by countries themselves and the commitment made by the international communities; they are failing behind in their endeavour to achieve the "Sustainable Development Goals". [4] opined that high level of external debt in developing country negatively impact their trade capacities and performance. Debt overhang affects economic reforms and stable monetary policies, export promotion and a reduction in certain trade barrier that will make the economy more market friendly and this enhances trade performance. Furthermore, debt decreases a government's ability to invest in producing and marketing exports, building infrastructure, and establishing a skilled labour force. [11] also stated that, the service of these debts have direct negative impact on economic development. He says "debt services encroach on resources needed for socio economic development and poverty reduction. It also contributes to negative net resources flow". [10] was of the opinion that the whole scale of white elephant development project in the country is the root cause of our external debt problems. He said emphasis needed to be placed on small rural development project so as to reverse the chaotic trend of urbanization and lessen the opportunity for corruption. According to [2] a correct analysis of external debt in a third world country such as Nigeria must be replaced in the content of the country's forceful integration into the western structural and dominated world capitalist economy as a peripheral appendage that provide natural resources and cheap lab our for the industrialization process in the west include lucrative markets for surplus of the advanced country's manufacturers and the advance countries get a very high cost of the manufactured product of the west. In yet another study showing an insight from cross-country regression analysis by [9] on the impact of aid and external debt in growth and investment the regression result were suggestive of a series of interesting relationships. This then is to say as a result of the explanatory regression there is quite strong evidence of positive impact of aid both on the growth rate in GDP per capital and the investment rate.
Outside Nigeria, [1] examined the effect of different types of debts on the economic growth in Malaysia during the period

1970 – 2006. Using Co-integration test, the findings suggest that all components of debts have a negative effect on long run economic growth. The Granger causality test reveals the existence of a short-run causality linkage between all debt measures and economic growth in the short-run. [7] investigated the impact of external debt on economic growth of Sudan from a period spanning 1978 – 2001. The study showed that export earnings have a significant positive impact while external debt and inflation had negative impact on Sudan's economic growth.

[12] investigated both the short-run and long-run relationships between economic growth and external debt service for Turkey during 1956 – 1996. The study employed a standard production function model analyzed using multivariate co-integration techniques. The Vector Autoregression estimates showed that there exists one Co-integration equation. It also revealed that debt service is negatively related to economic growth in the long-run. The causality test showed uni-directional causality between debt service and economic growth. Clements, [8] examined the channels through which external debt affects growth in low income countries. Their results suggest that the substantial reduction in the stock of external debt projected for highly indebted poor countries (HIPC) would directly increase per capita income growth by about 1 percentage point per annum. Reductions in external debt service could also provide an indirect boost to growth through their effects on public investment. [4] explored the relationship between external debt and economic growth in Pakistan for the period between 1972 – 2005, using time series econometric technique. Their result shows that external debt is negatively and significantly related to economic growth. The evidence suggests that increase in external debt will lead to decline in economic growth. Previous study by [11] on Pakistan analyzed the long run and short run relationships between external debt and economic growth. Annual time series data from 1970 to 2003 was obtained to examine the dynamic effect of GDP, debt service, capital stock and labour force on her economic growth. The study concludes that debt servicing burden has a negative effect on the productivity of labor and capital, thereby adversely affecting economic growth.

Theoretical Framework

The dual gap analysis explained that development is a function of investment and that such investment which require domestic savings, is not sufficient to ensure that development take place. There must be the possibility of obtaining from abroad the amount that can be invested in any country which is identical with the amount that is saved. Furthermore, if the domestic resources are to be supplemented from abroad, such as excess of import over export (i.e. M > E);

I – S

M – E

Hence, I – S = M – E

In national income accounting, an excess of investment over domestic saving is equivalent to excess surplus of import over export. Income = consumption + import + savings Output = consumption + export + investment Income = output Then Investment – Saving = Import – Export. This is the basis of dual gap analysis; ensuring that there is a country that requires saving and investment good import to achieve a particular rate of growth. If the available domestic saving fall short of the level necessary to achieve the target rate of growth, a savings investment gap is said to exist on a similar note, if the maximum import requirement needed to achieve the growth target is greater than the maximum possible level of export, then there is an export-import of origin exchange gap.

Conclusion/Recommendation

There is no doubt that Nigeria's huge external debt is partly responsible for the adoption of the Structural Adjustment Programme (SAP) introduced in 1986 to put the economy on a sustainable path of recovery. This implies if the high level of debt service payment could reduce significantly, Nigeria would be in a position to finance larger volume of domestic investments, which would enhance growth and development. Given the heavy burden of external debt and declining trend in world oil prices, Nigerian has been facing a difficult balance of payment prospect in an encouraging growth rate and negative net foreign exchange flows. Hence, this study concludes that there is a negative impact of debt on the economic growth of Nigeria, and its servicing adversely affects the country even more. Consequently, government should ensure that the acquisition of external debt is largely for economic reason so as to increase the productivity of the nation. Also, there is need to diversify the nation's export base as this will increase export earnings and reduce import dependency.

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