

# Impact of External Debt Management in Economic Growth: A Lesson from Nigeria

Onaolapo A.A

Department of Management Science and Accounting  
Ladoke Akintola University of Technology, Ogbomosho, Oyo State

Kayode.Samson. Oladejo

Department of Accounting, Joseph Ayo Babalola University, Ikeji-Arakeji, Osun State, Nigeria

## Abstract

The process of managing national debt in any nation affects the economic well being of citizens and their productive capacity. This is so given that once a debt is raised. It becomes contractually obligatory for the payment of their interest and capital as at when due becomes contractually obligatory This study was therefore carried out to examine the impact of external debt management in Economic growth of Nigeria within the period of 2000 -2009. Data employed are mainly secondary. They are sourced from journals, Magazine, Central Bank of Nigeria statistical Bulletin e.t.c. Collected data are analyzed using both qualitative and quantitative approaches. The qualitative aspect include the use of descriptive analysis whereby percentages are used to summarize the findings. Quantitative aspect include the use of both the descriptive and inferential statistics. Three hypothesis were tested using product moment correlation test and findings indicate relationship between the external debt and economic growth e.t.c

## BACKGROUND TO THE STUDY

The act of borrowing creates debt which, refers to the resources of money in use in an organization that is not contributed by its owners and does not in any other way belong to them. Financial resources generated through debt instruments by an organization or a nation constitute liabilities of such entity in the balance sheet. On the basis of their sources, debts are categorized as either internal or external debt.

National debts are unpaid amount or money borrowed by a government within its domestic territory while external debt refers to unpaid portion of external financial resources required for development purposes and balance of payments support which could be described as a repayable obligation owed to foreigners or non-residents and payable in foreign currency. External debt carries different maturities such as short, medium and long term of maturities. Nigeria external debt comprises of loans from different creditors which include Paris club of creditors, London club of creditors, Multilateral creditors. They include World Bank and its affiliates. The affiliated include international finance corporation (IFC), International Monetary Fund (IMF), African Development Bank (ADB), European Investment Bank (EIB) and International Fund for Agricultural Development (IFAD).

The external debt acts as a major constraint to capital formation in Nigeria. The burden and dynamics of external debt show that they do not have significant impact in financing economic development in Nigeria. For instance, Nigeria's external debt of about \$150million change in the beginning of the year 1978 as Nigeria at the lure of the international financial center, started to borrow huge sums from private sources at floating rate and with short term maturities. In 1978, the "Jumbo loans" alone was estimated at some US \$1 billion and in 1982 the value of Nigeria's external indebtedness was US \$8.631 billion which represented over 160% of Nigeria's Gross Domestic Product(GDP) for that year.

Debt management is the establishment of the conditions for the issue and redemption of public securities. It involves the process of administering the national debt that is, providing for the payment of interest and arranging the reinforcing of maturity bond. Once a debt is raised, it becomes contractually obligatory for the payment of their interests and capital as at when due. The way these debts are managed have a lot of implications for government revenue and expenditure as the debt and their interest would have to be repaid from current government revenue or through issuance of new debt instruments. Unless new debt instruments are issued, the immediate effect of debt management is that the more the proportion of current income set aside to repay and service debts, the less will be the amount that would be available to meet current budgetary obligations and vice versa. Debt management is therefore a policy because of the effects on income that would otherwise be available to meet current fiscal obligations (Afolabi, 1999).

In 1983, Nigeria refinanced her US\$2.1 billion insured trade arrears with London club of creditors and reconciled US\$7.4 billion uninsured arrears with Paris club to US\$3.8billion. Various new loan facilities have contracted in order to invest in projects whose returns are high as to pay up part of Nigeria's debt and debt conversion programme has been and is still being implemented for debt reduction (Omoruyi, 1996).

## STATEMENT OF THE PROBLEM

Anxious to achieve rapid economic growth and development in an environment characterized by wide savings and investment gaps, government contracted massive internal and external borrowing with little attention to the ‘rules of the game’ which include broad policy considerations which determine among other factors a country’s sustainable level of external borrowing and its efficient utilization. Too often external borrowings were uncoordinated as various arms of the government and government-owned enterprises independently canvassed for and acquired loans from international capital market, thus, the ‘rules of the game’ or national debt policy established for the debt management by the highest level of government are disregarded.

Closely allied to the uncoordinated borrowing by various arms of government is the lack of coordination among agencies involved in debt management. Too often, there are “kinks” in information flows between the agencies leading to conflicting figures on national debt given by them.

## RESEARCH QUESTIONS AND OBJECTIVES

1. What are the component of Nigeria external debt?
2. What impact does Nigeria External Debt Management have on National Balance Of payment?
3. To examine the relationship between the External Debt and Economic Growth.
4. To examine the impact of the debt management in the growth in Gross Domestic Product (GDP) and Money Supply.

## SCOPE AND SIGNIFICANT OF THE STUDY

The study is limited to external debt management between 1996 and 2006, This is with a view to examine the impacts of external debt management on the growth of Nigeria economy within the study period

## SIGNIFICANCE/JUSTIFICATION OF THE STUDY

The effect of management is the emergence of a debt overhang and an unsustainably high debt service burden. The debt crises emanating from inefficient debt management will eventually compel debtor (Nigeria) to undertake macro economic restructuring as well as adopt debt strategy and market related approaches aimed at eliciting relief from the creators in order to achieve growth in economy.

This study would therefore explore the various composition of external debt and their effect on the Nigeria economy.

On the basis of the above, this paper is therefore divided into five sections with the present section providing the introduction to the study. Subsequently the paper will examine the conceptual framework methods and discussions in sections two to four. The paper provides summary, conclusion and recommendation in the section five

## LITERATURE REVIEW

Debt arises as a result of divergence between government expenditure and government revenue, when government expenditure is greater than revenue the different have to be covered through debt creation. Debt can be Internal and external .internal debt occurs when government borrow money within is domestic economy and also external debt occurs when government borrows money outside is domestic economy.

According to Sachs (2002), growth will not take-off until capital stock has risen to a given threshold and as it rises, and investment and output rise, in a virtuous circle, the saving level will also continue to rise and at a given level, the rise in both capital and savings will be sufficient to engender self-sustaining growth. The main reason for opting for external finance, as a means of ensuring sustained development rather than utilizing only domestic resources available is provided by the ‘dual gap’ theory which postulates that ‘ investment is a functions of saving and in developing countries like Nigeria the level of domestic savings is not sufficient to find the needed investment to ensure economic growth.

External debt does not automatically transform into debt burden when funds are optimally utilized in an optimal condition, the marginal return is greater than or equal to the cost of borrowing . According to Edelman ( 1983), the critical factors affecting debt services capacity are returns on investment, the cost of borrowing and the rate of savings. Ubok-Udom (1978), enumerates the costs of external borrowing to include debt service burden which incorporates costs implied by the term structure of external loans, costs of resultant liquidity crisis, costs of the viciously cumulative debt, the manageability of the debt, costs of debt rescheduling and costs of import substitution among others.

According to Omoruyi (1995) gross external debt is the amount of disbursed and outstanding contractual liabilities of residents of a country to non resident to replay interest with or without principal. In other words external debt is a repayable obligation that has either a maturity of up to one year that is short term debt or a maturity of over one year that is, medium and long term debt which is owed to non residents and is

repayable in foreign currency (Oyejide et al, 1985). Another issue in debt acquisition and management is the determination of a sustainable level of debt. According to Ajayi and Khan ( 2000), sustainable foreign borrowing is measured by several ratios, such as debt to export, debt services to export , debt to GDP (or GNP) and external debt to Gross domestic income among others. Furthermore, the determination of the sustainable level of these ratios is indeterminable and their usefulness is reduced to a warning of potential explosive growth in the stock of foreign debt.

Economy policies can be divided into monetary policy and fiscal policy, Monetary policy is the process by which the government, central bank or monetary authority manage the money supply to achieve specific goals. But sometimes there are insufficient funds to manage the goals of the government such as achieving full employment. On the other hand, fiscal policy is the economic term that defines the set of principle and decisions of a government in setting the level of public expenditure. So therefore, external debts act as additional sources of funds to the initial insufficient fund in particular government expenditure.

Monetary policy rests on the relationship between the rates of interest in an economy, that is the price at which money can be borrowed, and total supply of money. Monetary policy uses a variety of tools to control one or both of these, to influence outcomes like economic growth, inflation, exchange rates with other currencies and unemployment. Where currency is under a monopoly of issuance, or where there is a regulated system of issuing currency through banks which are tied to a central bank, the monetary authority has the ability to alter money supply and this influence the interest rate (in order to achieve policy goals).

Capital flight has contributed a lot of problem to external debt. Capital flight refer to short-term capital outflow (Ajayi,2000). It involves how money response to political or functional crises and heavier taxes. Capital flight is common with developing countries known to be the major cause of underdevelopment of developing countries especially sub-Saharan African countries.

External debt is acquired to supplement domestic saving in order to increase investment, to bridge the gap between government expenditure and government income. The macro economic argument against capital flight is that it is perverse exportation if domestic savings and foreign exchange that is insufficient in low income countries and has the consequence of minding growth (Ajayi and Khan, 2000). It is generally believed that it is the private sector shift its fund abroad. The linkage between capital flight and external debt is the debt overhand argument, which states that large debt discourages domestic investment (Ajayi and Khan,2000).

Moreover, provided the growth rate of real (or nominal) gross domestic product is greater than the real (or nominal) interest rate on debt and as long as the productivity of borrowed resources is at least equal to the interest charged on the debt, then external debt is consistent with economic growth (Iyoha, 2000). In order to achieve economic growth, domestic savings should be supplemented by many types of external assistance which foreign borrowing is an important one. The mechanisms through which external debts affect economic growth is investment (Onah, 1994). Investment behaviour is adversely affected by debt servicing especially in indebted economics. The debt burden can depress investments and have economic growth through illiquidity and disincentive affects. The illiquidity affect results from the fact that there are only limited resources to be divided among consumption, investment and external transfers to service existing debt while the disincentive affects crises because expectations of future burden tend to discourage current investment (Onah, 1994). Using the national income accounting.

$$\begin{aligned} \text{Income} &= \text{Consumption} - \text{Imports} + \text{Savings} \\ \text{Output} &= \text{Consumption} + \text{exports} + \text{Investment} \\ \text{Income} &= \text{Output} \end{aligned}$$

Then investment savings can be supplemented by foreign borrowing to finance the import surplus, either directly or indirectly by providing at the highest rate allowed by the most limiting factor if there is no borrowing. Growth is a foreign exchange gap, that is, it is limited by the availability of foreign exchange. On the other hand, if the biggest gap is the savings- investment gap, growth is said to be investment limited, that is, limited by the availability of domestic saving, (Uniamikogbo, 1994).

In conclusion, most of the goods need for growth in the developing countries cannot be produced by the countries and must be imported by means of foreign borrowing.

### MODEL SPECIFICATION

The following models are designed to relate salient explanatory variables of the research focus. Such variables include external debt ; economic growth and money supply. For this purpose two sets of explanatory equations are developed to explain there relationship.

#### Model 1

This model identify basic variable to constitute Nigeria External debt.

This expressed thus:

$$ED = f ( Eb + \dots + Sr)$$

Where

ED = External Development

Eb = Eternal borrowing

Sr = Service ratio

Model 2

LED = f(Edmgt)

GDP = f ( VED + SR)

Where LED = Level of Economic Development

VED = Value of External Development

SR = Service Ratio

## STUDY METHODOLOGY

### STUDY DESIGN

Research design can be defined as the specification of methods and procedure for acquiring the information needed for the research (Green, 1970).

The approach used in the are existing data like Journals, Newspaper, Textbook, descriptions and different data tabulation analysis.

Other sources of data used in this study is secondary source. Relevant information on external debt management are gotten from various textbooks, magazines, newspaper, journals, various release on internet and majorly from the central Bank of Nigeria statistical bulletin, central Bank of Nigeria annual report and statement of account and federal office of statistical annual abstract of statistics. The researcher made use of the following method in analysing data collected: percentage, tabulation and coding and correlation.

### PROCEDURE FOR PROCESSING AND ANALYSING COLLECTED DATA

The analyses of data collected were both qualitative and quantitative. The qualitative aspect of analysis include the use of descriptive analysis. Here, percentage were used to summarize findings. Similarly, the quantitative aspect of analysis include the use of both the descriptive and inferential statistics.

There are many methods that could be used to test the hypothesis. In this project the product moment correlation test would be used which are presented as follows:

$$r = \frac{\pi \sum XY - (\sum X)(\sum Y)}{\sqrt{(\pi \sum X^2 - (\sum X)^2)[\pi \sum Y^2 - (\sum Y)^2]}}$$

where  $\lambda$  = Number of cases (sample)

X and Y = variables under consideration

$\Sigma$  = Summation sign

This formula above will be used to test for the hypothesis when two variables are involved that is variable X and Y

## DISCUSSION AND FINDINGS

On the basis of the objective and research questions identified for the study ;data obtained are analyzed and discussed below

Table 1: **Correlations showing the relationship between Nigeria external debt and Gross Domestic Product .**

		Correlations	
		External Debt Outstanding	GDP
External Debt Outstanding	Pearson Correlation	1	-.701*
	Sig. (2-tailed)		.024
	N	10	10
GDP	Pearson Correlation	-.701*	1
	Sig. (2-tailed)	.024	
	N	10	10

\*. Correlation is significant at the 0.05 level (2-tailed).

The correlations of table 1 showed there exist negative relationship between the external debt and the Gross Domestic Product (GDP) of the country. Moreover, based on the correlations above, It can be said that the external debt management did not enhance the GDP of the country as it shows a negative correlations of -0.701 that exist between them.

**Table 2 showing Correlation showing relationship between Nigeria external debt and National Balance of Payment**

		Correlations	
		External Debt Outstanding	Balance of Payment
External Debt Outstanding	Pearson Correlation	1	.265
	Sig. (2-tailed)		.460
	N	10	10
Balance of Payment	Pearson Correlation	.265	1
	Sig. (2-tailed)	.460	
	N	10	10

The correlations of table 2 shows there exist a positive relationship between the External debt management and the Gross Domestic Product (GDP) of the country and therefore it can be deduced that the external debt management has significantly affect the country balance of payment. Although it revealed a correlations of 0.265 which though positive but shows a weak correlations exist between them.

**Table 3 showing correlation relationship between Nigeria external debt, National Balance of Payment and GDP**

		Correlations		
		VAR00001	VAR00002	VAR00003
VAR00001	Pearson Correlation	1	.561	.018
	Sig. (2-tailed)		.073	.958
	N	11	11	11
VAR00002	Pearson Correlation	.561	1	-.098
	Sig. (2-tailed)	.073		.774
	N	11	11	11
VAR00003	Pearson Correlation	.018	-.098	1
	Sig. (2-tailed)	.958	.774	
	N	11	11	11

The correlations of table 3 shows there exist a positive relationship between the External debt management and the Gross Domestic Product (GDP) and more so a very slight relationship between the External Debt and the Balance of payment of the country. So therefore it can be deduced that the external debt management has significantly affect the country Gross Domestic Product of the country as its correlations revealed 0.561 and slightly affect the country's balance of payment as it revealed a correlations of 0.018 that exist between them.

### CONCLUSION AND RECOMMENDATION

The intention of the study on the topic was to analyze and explore the various compositions of external debt and their effect on the Nigeria economy. It also explore how to avoid being in debt and various debt strategies and market related approaches to solving the debt problems in Nigeria.

The external debt management is the establishment of the conditions for the issue and redemption of public securities. It involves the process of administering the national debt that is, providing for the payment of interest and arranging reinforcing of maturity bond. Therefore, based on the analysis and tested hypothesis we can deduce that the external debt management have a positive impact/ on Nigeria economy development.

However, on the basis of the finding, government should try to maintain strict budget discipline and strive to avoid huge budget deficit. Government should restrain its spending especially with respect to non-directly productive as these aggravate the external debt outstanding. The government should increase its exports of goods and services and should not limit its export mainly to oil but diversify its export base to other

Moreover, the existence of the various measures does not mean the reduction of external debt stock. Thus, it is my belief if the policies and recommendations mentioned are implemented, there would be reduction to the minimum level of Nigeria's external debt stock.

## References

- Ajayi S.I and khan (2000). External Debt and Capital Flight in sub-Saharan Africa. IMF Institute. International monetary Fund. Washington D.C.  
 Central bank of Nigeria Statistical Bulletin (2009)  
 Iyoha M.A (2000). The impact of external debt reduction on Economic growth in Nigeria  
 Omoruyi S.E (1996). Efficient Debt management: A pre-requisite for Economic and Monetary stability.  
 Onah F.E (1994). External debt and economic growth the Nigeria Economic Society

## APPENDIX 1

### Gross Domestic Product (N; Million)

Year	Amount
2000	329,178.7
2001	356,994.3
2002	433,203.5
2003	477,533.0
2004	527,576.0
2005	561,931.4
2006	595,821.6
2007	634,251.1
2008	672,202.6
2009	716,949.7

Source: Central Bank of Nigeria Statistical Bulletin (2009)

### External Debt Outstanding (N' Million)

Year	Amount
2000	3,097,383.3
2001	3,176,291.0
2002	3,932,884.8
2003	4,478,329.3
2004	4,890,269.6
2005	2,695,072.2
2006	451,461.7
2007	431,079.8
2008	493,180.2
2009	590,441.1

Source: Central bank of Nigeria Statistical Bulletin (2009)

### National Balance of Payment (N' Million)

Year	Amount
2000	314,139.2
2001	24,729.9
2002	-563,483.9
2003	-162,298.2
2004	1,124,157.2
2005	--
2006	--
2007	--
2008	--
2009	--

Source: Central bank of Nigeria Statistical Bulletin (2009)

The IISTE is a pioneer in the Open-Access hosting service and academic event management. The aim of the firm is Accelerating Global Knowledge Sharing.

More information about the firm can be found on the homepage:

<http://www.iiste.org>

### CALL FOR JOURNAL PAPERS

There are more than 30 peer-reviewed academic journals hosted under the hosting platform.

**Prospective authors of journals can find the submission instruction on the following page:** <http://www.iiste.org/journals/> All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Paper version of the journals is also available upon request of readers and authors.

### MORE RESOURCES

Book publication information: <http://www.iiste.org/book/>

Academic conference: <http://www.iiste.org/conference/upcoming-conferences-call-for-paper/>

### IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digital Library, NewJour, Google Scholar

