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Managing Nigerian Debt: The Practical Solutions

Waidi Kareem ADEBIYI[1*] Johnson Kolawole OLOWOOKERE[2]
1. Department of Accountancy, Federal Polytechnic, Ede, PMB 231, Ede, Osun State, Nigeria
2. Management and Accounting Department, Ladoke Akintola University of Technology, Ogbomoso, Oyo State, Nigeria
* E-mail of the corresponding author: biyiadew@yahoo.ca

Abstract
Debt is an important component of fiscal policy. This study investigates the implications of debt on economic growth and development .It also discusses how the debts can be managed. Secondary data were used for the study. The Ordinary Least Squares Method (OLS) model was used to analyze the time series data extracted from CBN statistical bulletin and Debt Management Office in Nigeria between 1990 and 2011. The result shows that the debt holding of government far above certain healthy threshold has negative effect on economic growth. It can lead, not only, to capital flight but can also discourage private investment. Hence, the dramatic growth in the domestic debt /GDP ratio has raised many doubts about fiscal sustainability of the current economic policy. Therefore, we recommended that the establishment of the Debt Management Office should be seen as a positive step towards enhancing the efficiency of debt management and the effectiveness of monetary policy.
Keywords: Debts, Debt Management Office, Economic Growth, Foreign Direct Investment

1. Introduction

Debt is created by the act of borrowing. It is defined by Oyejide, Soyode and Kayode (1985) as the resource or money in use in an organization which is not contributed by its owner and does not in any other way belong to them. It is a liability represented by a financial instrument or other formal equivalent. In modern law, debt has no precisely fixed meaning and may be regarded essentially as that which one person legally owe to another or an obligation that is enforceable by legal action to make payment of money. The origin of Nigeria external debt was dated back to 1958 when a sum of US$28 million was used to finance the Nigeria Railway Corporation (Abdullahi, Aliero and Abdullahi, 2013).

At the time of independence in 1960, Nigeria was heavily dependent on agriculture as the mainstay of the economy. Shortly after independence, about 64 percent of the gross domestic product originated in the agricultural sector. The contribution of this sector, however, systematically declined until it reached an all-time low of about 17 percent in 1982. Nigerian oil came on the economic scene vigorously in 1970 when Nigeria became a member of the oil-producing nations. From then on, oil became the catalyst element in Nigeria's growth process. Nigeria benefited immensely from the sharp price increases in 1973/74 and again in 1979/80. By 1976, oil had become the major source of government revenue and the main foreign exchange earner—over 80 percent in both cases. Consequent upon the large revenue from oil, its relative importance increased at the expense of other sectors (Ajayi, 1991). These revenues provided the basis for significant increases in government expenditure designed to expand infrastructure, and to improve the non-oil productive capacity. Indeed the large oil revenues "not only provided government with the financial resources to undertake new programmes and projects and to expand oil programmes, but they affected the very institutions which were to make policy and the nature of centralization of authority and decision making in Nigeria" (Bienen, 1983). Pressures on expenditure were exerted from all sides. The creation of more states meant more expenditure on infrastructure. In spite of the spending on some important projects, some projects were undertaken without sufficient attention being paid either to their economic viability or to the executive capacity of government. Ajayi (1989) traces the origin of Nigeria debt problem to the collapse of the international oil price in 1981 and the persistent suffering of the international oil market and partly due to domestic lapses. As a result of the debt problem, credit facilities gradually dried up, which led to a number of projects being stalled. The needed growth however is disturbed by two factors: the limitation imposed by inappropriate domestic policy and the external factor, which are beyond the control of the economy.

1.1 Statement of the Problem

An escalating debt profile presents serious obstacles to a nation's path to economic growth and development. The cost of servicing debt may expand beyond the capacity of the economy to cope, thereby impacting negatively on the ability to achieve the desired fiscal and monetary policy objectives. Furthermore, a rising debt burden may constrain the ability of government to undertake more productive investment programmes in infrastructure, education and public health. To avoid such a situation, it is imperative that the quantum and structure of the nation's debt be carefully managed in a manner that is consistent with the country's growth and development aspirations. (Sanusi, 2003). Many methods of managing these problems were introduced such as Structural Adjustment Programme, Debts Rescheduling and Restructuring, and Highly Indebtedness Poor Countries Initiative formulated by the IMF/world bank. Yet debt repayment has greatly affected the country's economic performance.

1.2 Objective of Study

The broad objective of this study is to identify workable solution on how to manage Nigerian debts. The specific objectives are to:

i) examine the relationship between debt and economic growth

ii) investigate the implication of debt on economic growth and development

2 Literature Review

Oshadami (2006) defines Domestic Government debt as debt instruments issued by the Federal Government and denominated in local currency. In principles, state and local government can also issue debt instrument, but limited in their ability to issue such. Debt instrument consist of Nigerian Treasury certificates, Federal government development stocks and treasury bonds. Out of these, treasury bills and development stocks are marketable and negotiable, while treasury bonds; ways and means advances are not marketable but held solely by the Central Bank of Nigeria, (Adafu and Abula 2010). The Central Bank of Nigeria (CBN) as banker and financial adviser to the federal government is charged with the responsibility of managing the domestic public debt. (Alison, 2003) reveals three principal reasons often advanced for government domestic debt. These are: for budget deficit financing, for implementing monetary policy and to develop instruments so as to deepen the financial market.

2.1 Public Debts and Economic Growth

Lipsey (1986) defines economic growth as the positive trend in the nation's total output over long period of time. This implies a sustained increase in Gross Domestic Product (GDP) for a long time. Schiller (1999) opines that economic growth is an increase in output (real GDP), an expansion in product possibility curve. Schiller (1999) view was not different from that of Dolan and Lindsey (1991) who sees economic growth as most frequently expressed in terms of increase in Gross Domestic Product (GDP), a measure of the economy's total output of goods and services. This GDP as a measure of economic growth, like any other economic quantitative must be expressed in real terms. That is, it must be adjusted for the effects of inflations as for it to provide a meaningful measure of growth overtime. Degefe (1992) also discovered a negative effect of external debt on growth. Fosu (1996) argued that debt can additionally influence economic growth via effect on the productivity of investment. And even if debt service payments do not reduce saving and investments significantly, they could still decrease output growth directly by diminishing productivity as a result of the adverse changes in investment mix. Ajayi (1991), Osei (1995) and Mbire &Atingi (1997) use the simulation analysis to show the impact of the debt burden indicators on economic growth under different scenarios.

2.2 External Debt Burden and Economic Growth in Nigeria

External loan has the inherent capacity to promptly put a country on developmental pedestal, but, as it has been, its misuse involves huge social and human costs. It could also lead to decline in the country's external assets and decline in the productive capacity of the national economy with all its attendant effects on macroeconomic environment, etc. For instance, United Nations Children's Emergency Fund (UNICEF) noted in 1990 that about a thousand people die every day in Africa due to debt burden carried by the continent (CIA World Fact book, 2008). A foreign loan becomes debt or debt crises when such loan is either mismanaged or not committed to development-oriented projects. The debt crisis that originated from the poor management of loans was further compounded by sheer mismanagement of resources, Nigeria's external debts stood at a little over $35 billion in 2006. Initially, Nigeria owed $35 billion and $30 billion of that was owed to the Paris Club group of creditors of 15 countries, most of them Western countries and Japan. Nigeria exited the Parish Club through the debt cancellation (Nweala, 2006). So, $5 billion is left. Nigeria does not owe IMF any longer. Of the $5-6 billion that is left about $2.5 billion is owed multinational Institutions. This includes the World Bank, African Development Bank, among others, and these are long term, 30 to 40 years loan of little or no interest.

2.3 **The Debt Management Office**

The Debt Management Office (DMO), the custodian of the nation's debt profile, issued a warning showing a rising domestic debt and its likely consequences. According to the DMO, a hefty 85 percent of Nigeria's public borrowing comes from the domestic market, while only 15 percent represents external debt. This has ominous economic implications. It is not hard to see how our country got into this quagmire. At the moment, the total domestic debt stock is ₦3 trillion, up from 2.1 trillion in 2009 and ₦1.7 trillion in 2007.In terms of tenor, the domestic debt was highly short tenured until recently. For instance, in 1994 treasury bills accounted for 42 percent of domestic debt, Treasury bond accounted for 48 percent, treasury certificate accounted for 9.16 percent and development stock accounted for 8.22 percent of domestic debt and this was the trend until 2007. In 2002, treasury bill accounted for 62.93 percent, treasury bond accounted for 36.93 percent and development stock which is the long term instrument accounted for a mere 0.14percent of domestic debt. The implication of this is that the debt was used to finance recurrent expenditure which was not growth inducing. However, this situation was reversed from 2007 as the contribution of treasury bills to domestic debt fell to 26.50 percent. Treasury bond accounted for 18.80 percent and federal government bonds which is the long term instrument accounted for 54.67 percent of the domestic debt.(see Table 1).DMO puts the country's domestic debt stock at N5,622.84bn as at December 31, 2011 up by 23.53% from N4,551.82bn as at December 31, 2010. The ratio of domestic debt stock to GDP is estimated at 15.11%. The breakdown of the total domestic debt stock by instrument type as at December 2011 shows that the FGN Bonds accounted for N3,541.20bn representing 62.98%; Nigerian Treasury Bills (NTBs) accounted for N1,727.91bn, representing 30.73% and Treasury Bonds (TBs) accounted for N353.73bn, representing 6.29%. The domestic debt service payments including refinancing as at 2011 were N537.39bn. Of the N537.39bn paid, ₦186.72bn (34.75%) represents the interest on Nigerian Treasury Bills (NTBs), N293.79bn (54.67%) represents the interest on FGN Bonds, ₦56.64bn (10.54%) represents the interest and principal on Treasury Bonds and ₦233.75mn (0.04%) represents interest and principal on Development Stocks.

Table 1: Trends of Domestic Debts by Instruments in Nigeria 2004-2010 (N'Billion)

Instruments	2004	2005	2006	2007	2008	2009	2010	2011
FGN Bonds	72.56	250.83	643.94	1,186.16	1,445.60	1,974.93	2,901.60	3541.2
% share of the total	-5.3	-16.4	-23.6	-28.7	-62.3	-61.4	-63.75	-62.98
Treasury Bills	871.58	854.83	1667.69	2533.26	471.93	787.48	1,277.10	1727.91
% share of the total	-63.6	-56	-61.2	-61.4	-20.3	-24.5	-28.06	-30.73
Treasury Bonds	424.94	419.27	413.6	407.93	402.26	392.07	372.9	353.73
% share of the total	-31	-27.4	-15.2	-9.9	-17.3	-12.15	-8.19	-6.29
Development Stock	1.25	0.98	0.72	0.62	0.52	0.52	0.22	-
% share of the total	-0.09	0	0	0	0	0	0	-
Promissory Notes	-	-	-	-	-	63.03	-	-
% share of the total	(-)	(-)	(-)	(-)	(-)	-1.95	(-)	-
Total	1,370.33	1,525.91	2,725.95	4,127.97	2,320.31	3,218.03	4,551.82	5622.84
	-100	-100	-100	-100	-100	-100	-100	-100

Source: DMO, 2011

Nigeria's domestic debt stock has dealt a heavy blow to the Gross Domestic Product (GDP), which measures the aggregate contributions of goods and services produced in the country. Domestic debt reduction in Nigeria has taken centre stage for conversing realistic pricing of petroleum products in Nigeria as the domestic debt profile has been rising astronomically and if not controlled could create some unfavorable consequences as crowding out private sector investment, poor GDP growth etc.,(Okonjo-Iweala,2011). On the other hand, government has to continue to financing projects to grow the economy and one viable option of doing so is by issuing debt instruments. For example, the 2012 national budget presented to the national assembly contains a deficit of ₦1.11trillion which has to be financed majorly through domestic debt. As at September 2011, Nigerian domestic debt stood at N5.3 trillion, an equivalent of $34.4 billion while external debt was $5.6 billion bringing the National debt to a total of 40 billion dollar which amounted to 19.6 percent of GDP. Nwankwo (2011), shows that the debt ratio is still below the internationally unacceptable standard of 40 percent of GDP.

The external indebtedness of African countries is an obstacle to the restoration of the conditions needed for growth (World Debt tables 1987—88,). The debt burden of a country inevitably imposes a number of constraints on its growth prospects. The burdens of principal and interest payments for instance drain the nation's resources and curtail the possible expenditure of resources on other productive ventures. This is even more constraining considering that the incomes from which debts are to be serviced is very little. This gives rise to three macroeconomic problems: the macroeconomics of earning foreign exchange, finding extra budget resources for debt service, and adjusting to a reduction in spendable resources (Ajayi, 1991). External debt of poor countries affects their national development in many ways, with both economic and social consequences, which are further compounded by generally poor economic performance. Even with concessional flows of finance and as described above, current debt relief mechanisms, the external debt service payments of Nigeria remain unsustainably high. Links between economic performance and the debt burden can be observed in the impact on investment fund due to the 'debt overhang' and 'crowding out' effects. There is reduced access to international financial markets, and the instability created by a large stock of debt. The 'debt overhang' discourages investment and constrains growth, while at the same time high levels of debt servicing reduce public investment. It has recently been argued that a high debt burden also encourages capital flight, through creating risks of devaluation, increases in taxation, and thus the desire to protect the 'real' value of financial assets. Capital flight in turn reduces domestic savings and investment, thus reducing growth, the tax base and debt servicing capacity.

Table 2: Trends in Real GDP and Public Debts Outstanding (₦'Millions)

YEARS	REAL GDP	EXTERNAL DEBT	DOMESTIC DEBT	INTEREST RATE	INFLATION
1990	267549.99	298,614.4	84,093.10	18.50	7.5
1991	265379.14	328,453.8	116,198.70	14.50	12.7
1992	271365.52	544,264.1	177,961.70	17.50	44.8
1993	274833.29	633,144.4	273,836.40	26.00	57.2
1994	275450.56	648,813.0	407,582.70	13.50	57.0
1995	281407.4	716,865.6	477,733.89	13.50	72.8
1996	293745.38	617,320.0	419,975.60	13.50	29.3
1997	302022.48	595,931.9	501,751.10	13.50	10.7
1998	310890.05	633,017.0	560,830.20	14.31	7.9
1999	312183.48	2,577,374.4	794,806.60	18.00	6.6
2000	329178.74	3,097,383.9	898,253.90	13.50	6.9
2001	356994.26	3,176,291.0	1,016,974.00	14.31	18.9
2002	433203.51	3,932,884.8	1,166,000.70	19.00	12.9
2003	477532.98	4,478,329.3	1,329,680.00	15.75	14.0
2004	527576.04	4,890,269.6	1,370,325.20	15.00	15.0
2005	561931.39	2,695,072.2	1,525,906.60	13.00	17.8
2006	595821.61	451,461.7	2,725,947.30	12.25	8.2
2007	634251.14	431,079.8	4,127,973.50	8.75	5.4
2008	672202.55	493,180.2	2,320,310.00	9.81	11.6
2009	718977.33	590,441.1	3,218,030.00	7.44	12.5
2010	776332.21	689,845.3	4,551,822.39	6.13	13.7
2011	838521.09	896,832.6	5,622,843.71	9.19	10.8

Source: CBN Statistical bulletin 2011.

The diversion of foreign exchange to debt servicing also limits import capacity, competitiveness and investment, and thus growth. In Nigeria this has important consequences for economic growth. The long-term costs associated with debt crowding out foreign investment become more difficult to quantify. The amount owed to this category by Nigeria as at December 2004 was US30.05 Billion. Debt service payment in 2001 and 2002 to them were US33.81 and 34.9 Million. Available data from the Debt Management Office [DMO] shows that Nigeria's total external debt stock as at March 31, 2010 stood at US$5,227.04mn representing an increase of 14.16% from the December 31, 2009, figure of US$4,578.76mn. The external debt as at March 2011 represents 14.29% of total debt stock of N5, 681.05bn. The breakdown of the debt showed that 73.73% was owed to Multilaterals, which includes the World Bank Group, International Fund for Agricultural Development [IFAD], African Development Bank Group (ADB), International Development Bank (IDB) and Economic Development Fund (EDF); 6.69% was owed to Non-Paris Group of creditors and 19.57% was owed to others. The debt burden increases Africa's dependence on the outside world; Nigeria was already in default on $3,947,297,536.36 billion worth of Paris Club debts owed to sovereign lenders, and was struggling to service its $3.5 billion London Club obligations (DMO, 2009). Lagos State top the list with a debt service requirement of $347,933,278.16 million and followed by Kaduna State with $135,805,842.68 million The trend of the external debts highlights the fact that much of the country's external debt is owed to fifteen creditor countries belonging to the Paris club, as a percentage of the total external debt, Nigeria's indebtedness to this group rose almost consistently from about 30% in 1983 to about 80% in 2001. This huge external debt constitutes a major impediment to the revitalization of its shattered economy as well as the alleviation of debilitating poverty.

3.0 Methodology

This study is an explanatory study. Saunders, Lewis and Thornhill (2007) states that studies that establish causal relationships between variables may be termed explanatory studies. They emphasized that this has to do with studying a situation or a problem in order to explain the relationships between variables. This research strategy was considered necessary because of its ability to view comprehensively and in detail the major questions raised in the study.

3.1 Model Specification

The economic model used in the study is given as:

Y = β0 + βit(Fit) + eit.. (1)

Where, Y is the dependent variable. β0 is constant; βit is the coefficient of the explanatory variable to show the linearity between the variables, Fit is the explanatory variable and eit is the error term (assumed to have zero mean and independent across time period).

RealGDP = B0 + B1external Debt + B2 Domestic Debt+ B3 Interest Rate + B4 Inflation Rate + Eit… (2).

3.2 Discussion of Result

<u>Regression Model</u>

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	325655.644	80876.671		4.027	.001
	EXTERNAL DEBT	.016	.010	.128	1.615	.125
	DOMESTIC DEBT	.105	.013	.875	8.143	.000
	INTEREST RATE	-4449.167	4742.392	-.103	-.938	.361
	INFLATION RATE	-222.189	825.038	-.023	-.269	.791

a. Dependent Variable: Real GDP

The variability as measured by coefficients of variation (β) is expectedly negative for interest rate and inflation rate. This implies that servicing of debt and the growth in real GDP is inversely related which is logical in the sense that cost of servicing the debt is flowing out which will invariably reduces the growth of real GDP.

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6.821E11	4	1.705E11	42.637	.000[a]
	Residual	6.799E10	17	3.999E9		
	Total	7.500E11	21			

A. Predictors: (constant), inflation rate, external debt, domestic debt, interest rate

b. Dependent Variable: REAL GDP

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.954[a]	.909	.888	63238.93195

A. Predictors: (constant), inflation, external debt, interest rate, domestic debt

The values of R^2 [0.909] and the adjusted R^2 [0.888] in the above regression estimates indicate that the model adequately explain the influence of debt on economic growth using the variables given above. The coefficient of determination (R^2) is 0.909 which shows 90.9% of the variation in the dependent variable has been explained by the independent variables. While 9.1% remain unexplained in the model.

Hypothesis

The decision rule is that, if t-calculated is greater than t-tabulated ($t^c > t^t$), we reject null hypothesis (H_0) and accept the alternative hypothesis (H_1) and vice-versa.

From the table above and at 5% level of significance, t-calculated is 2.131. Domestic Debt, Interest Rate and Inflation Rate are statistically significant since ($t^c > t^t$) i.e (8.143> 2.131, -0.938> -2.131 and -0.269> -2.131). While External Debt is statistically insignificant since ($t^c < t^t$) i.e (1.615< 2.131). Hence, Domestic Debt, Interest Rate and Inflation Rate have significant influence on Economic Growth while External Debt, because of its current size, does not influence Economic Growth significantly.

3.3 Summary of Findings

Debt which is the act of borrowing was initially encouraged to aid economic growth. The aim of external borrowing was to bridge the domestic resource gap in order to accelerate economic development. The loan becomes debt or debt crisis when such loan is either mismanaged or not committed to development oriented project. The burdens of principal and interest payments drain the nation resources and limit the possible expenditure on other productive resources.

3.4 Conclusion and Recommendations

Debt services have a statistically significant impact on the economic growth (RGDP) of Nigeria. Government should place embargo on new loans especially to the state government and other government parastatals except for important economic reasons which are inevitable and for project which are self floating and self sustaining. Government policy that deters savings (such as negative real interest rates) encourages not only capital outflows, but also contributes to debt accumulation because external financing is needed to bridge the gap. All these domestic factors increase borrowing needs and lower the earnings from exports, and in the process reduce the ability to meet the rising debt service obligations. On the whole, leadership becomes critical, both in terms of political will and ability to mobilise resources for the attainment of national objectives. Ajayi (1989), advocates the revival of the economy growth as the best and most durable solution to the debt burden. It is important, therefore, to adopt the leadership and management styles that inspire confidence in those who will be involved in the restructuring of the economy. Restructuring of the economy also involves restructuring of interests which are invariably conflicting and have to be balanced. The essence of this, however, is that leadership role is crucial in the overall development of any economy. The leaders in Nigeria should transit from ineptitude to competence; moral corruption to moral decency; parochialism to purposeful leadership that serves not to oppress the people.

The establishment of the Debt Management Office should therefore be seen as a positive development that will enhance the efficiency of not only domestic debt management but also the effectiveness of monetary policy. Government should provide enabling social and economic environment as this will encourage entrepreneurship and promote foreign direct investment.

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Waidi Kareem ADEBIYI is an associate member of the Institute of Chartered Accountants of Nigeria. He holds B Sc degree in Accounting from Obafemi Awolowo University, Ile-Ife and M Sc in Accounting from University of Lagos. He is currently a Ph D student in Accounting and Finance at Nasarawa State University, Keffi, Nigeria. He teaches Taxation and Management Accounting at Federal Polytechnic Ede, Nigeria

Johnson Kolawole OLOWOOKERE is an associate member of the Institute of Chartered Accountants of Nigeria. He holds B Sc degree in Accounting from Ogun State University, Ago-Iwoye, M Sc in Accounting from University of Lagos, M.Phil, in Business Administration from Obafemi Awolowo University, Ile-Ife, Nigeria. He teaches Auditing and Management Accounting at Ladoke Akintola University of Technology Ogbomoso, Nigeria.