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Effect of External Debt Servicing On Economic Growth: Nigeria Experience

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ABSTRACT

This study aims to review and analyze the effect of External Debt Servicing on economic growth with particular emphasis on Nigeria: The Variables on which data are collected include: Gross Domestic Product, External Debt, Debt Servicing, Foreign Exchange rate, External Reserves. The scope of the study spanned the period from 1999 to 2019. Data were collected from secondary sources and analyzed using ordinary least square regration (OLS).The simple regression of Gross Domestic Product (GDP) on debt shows that co- efficient is significant with P-Value of 0.00 and F-Statistic of 82.375. The R-Square is 0.82 which is very strong indicating a significant good relationship. The t-test of significant relationship between government debt servicing and gross domestic product (GDP) is 9.076 with P-Value of 0.05, which also implies that debt servicing significantly affected Gross Domestic Product in Nigeria during the period under review. The findings revealed that debt repayment or servicing has negative and insignificant effect on Nigeria's economy. The study recommends among others: that loans procured should be used on basis and infrastructural development in accordance with fiscal responsibility Act, ii. Government should put in place proper debt management policy that minimizes negative effect of debt servicing on the economy. iii. Government should stick to the provisions of fiscal responsibility policy framework in respect of borrowing and management of debt levels and its interest cost.

Keywords: External debt, Debt servicing, Fiscal Responsibility, Economic growth.

INTRODUCTION

Debt is the sum of money that is borrowed for a certain period of time and to be returned along with interest. According to [1], debt referred to the resources of money used in an organization which is not contributed by its owners and does not in any way belong to them. Public debt can either be domestic or external debt. Domestic debts are those debts incurred within the country, while external debts are incurred outside the shore of a country. [2], defined external debt as packages that consist of a contribution of financial, technical vis-à-vis managerial requirements emanating from outside the country aimed at supporting economic growth and development of a country and are repayable at a specified future date in foreign currency. It is a major source of government receipts or income. The accumulation of debts (external) should not be seen or signify slow economy, rather it is a country's inability to meet its debt obligation compounded by lack of information on the nature, structure and magnitude of the external debt [3]. The issue of Nigeria's public debt is important in recent times, especially as the level of her external debt has escalated which is required to be serviced as well as its attendant possible effect on different operating sectors of the economy. Debt servicing according to [4] is the amount of money required to make payment on the principal and interest on outstanding loans, bonds or the principal maturing bonds. Any individual, company or government unable to make such payments is said to be unable to service one's debt. [5], described debt service as that fund required to cover the repayment of interest and principal on a debt for particular period. [6], opined that government must borrow if its revenue is insufficient to pay for expenditure, a situation called deficit. Fiscal deficits occur when the revenue received by a government is less than spending during a financial year; these deficits will create the need to borrow which can be internal or external. This study is however concerned with external debt servicing and its effect on developing economy like Nigeria. Nigeria external debt had its origin in 1958 when a loan of USD 28 million was obtained from railway construction between 1958 and 1977, the level of foreign debt was minimal as debt contracted during the period were conventional debts from bilateral and multilateral sources with longer repayment period and lower interest rate [7]. From 1978 following the collapse of oil price which exerted considerable pressure on government finances it became necessary to borrow for balance of payments supports and project financing. This led to the promulgation of Decree N0 30 0f 1978 limiting the external loans the government could raise to 5 billion naira. The first major Federal government borrowing after the decree N0 30 of 1978 was USD 1 billion Dollar loan from the international capital market (ICM) Jumbo loan which increased Nigeria total external debt to $22 billion. Nigeria external debt increased so much due to excessive borrowing from international agencies and countries at non-concessional interest rate as a result of decline in earnings and this has created difficult situation for the government to service its debt, but continue borrowing.

Literature Review:

Empirical Review

There have been several attempts by scholars to empirically review the external debt servicing-economic growth link and its overhang and crowding out effect in Nigeria and other parts of world. In a study of the impact of external debt and economic growth in Nigeria, [8] found that external debt was positive while debt service was negative. This was because debt capital adds to capital formation and positively impacted on economic growth. On the other hand debt-servicing ration reflects capital outflow and consequently deteriorates the performance of a country and thus reduces the real Gross Domestic Product (GDP). It also confirms the theoretical expectations that debt service diverts resources away from the debtor country. But because total debt stock depicts a positive relationship in the results instead of a negative relationship and statistically significant at all levels, they therefore concluded that total debt stock less debt service, still results to a positive balance that enhances capital accumulation that positively impacts economic growth.

In a related study, [7] studied on debt servicing and economic growth in Nigeria, using ordinary least square-multiple regression method to determine whether debt payment to multilateral financial creditors, like Paris club, London club and other creditors have inverse relationship with gross domestic product (GDP) and Fixed Capital Formation at Current Price (GFCF) from (1981- 2004). The study showed that debt payment to London Club Creditors, Paris club creditors and other creditors have significant impact on the GDP and GFCF. In a study carried out by [9] on the effect of external debt relief on sustainable economic growth and development in Nigeria, using chi-square, Regression and correlation analysis to test the relationship between external and internal debt stock in relation to debt relief. The study revealed that there is positive relationship between external and internal debt stock and debt relief. [10], investigated the impact of external debt and its servicing on the Nigeria economy; data for the study was collected from secondary source, while the regression and granger causality methods of analysis were applied. The outcome of the analysis showed that external debt and its servicing has negative effect on gross domestic product (GDP). The granger causality test showed that gross domestic product (GDP) has a un-directional causal relationship with external debt service which runs from GDP to external debt service. The study recommended that external debt should largely be for economic reasons rather than social or political purposes as they would increase the productivity of the Nation. [3], examined the impact of public debt on economic development in Nigeria, using annual time series data sparined 1986- 2014. The study employed the AUGMERNTED Dickey – fuller test, Johnson co-integrated test, error correction method (ECM) and Granger causality test. The Johnson co-integration test results revealed the presence of a long-run relationship among the variables viz: external debt, stock domestic debt, external debt servicing, domestic debt servicing and economic development in Nigeria. The ECM results showed that external debt stock and external debt servicing have insignificant negative relationship with economic development, while domestic debt servicing/payment was significant but inversely related to economic development in Nigeria. The study recommended that government should reduce the level of external debt it accumulates over time, but rather resort to domestic debt accumulation for development of the economy.

[2], reviewed the impact of external debt on economic growth in Nigeria between 1980 to 2012. They empirically examined the data using co-integration test and error correction test. Findings from the study found that non-existence of debt overhang problem for Nigeria and it recommended that development activities in Nigeria be financed through increased export earnings spearheaded by export led growth strategy as well as investment in human capital. [11], investigated the relationship between external public debt servicing and receipt and exchange rate fluctuation in Nigeria from 1981 to 2013. The study used ex-post-facto design method. The findings of the study showed that external receipts and external debt servicing have positive and long-run relationship with naira exchange fluctuation. The study concluded that whereas external public debt receipts affect exchange rate positively, external public debt servicing affects exchange rate negatively. [12], analyzed the impact of external debt on economic growth in Nigeria using the Variance decomposition and impulse response from Vetor Auto-Regression (VAR). Based on the two-stage data processing, the result revealed that causation between debt and economic growth is weak in Nigeria context and external debt could thus be used to forecast improvement or slowdown in economic growth in Nigeria. The study further revealed that for debt to promote growth, fiscal discipline and high senses of responsibility in handling public fund should be the watchword of Nigeria leaders.

Fiscal Responsibility Policy

Fiscal responsibility is the agreed set of policies, processes or arrangements intended to improve fiscal outcomes, discipline, transparency and accountability by requiring governments to commit to monitor-able fiscal policy objectives and strategies. It is an Act to provide for prudent management of Nations resources, ensure long term macro-economic stability of the National economy and secure greater accountability. According to [13], the nation's economic future and fiscal responsibility are directly linked. It has important long-run effects on the health of the economy, particularly through its impact on national saving and the growth of productivity. Fiscal responsibility policy is designed to provide the framework to which the government will borrow and manage the attendant debt levels and interest cost [13] It is designed the main to provide rules to govern both for which purposes the government may borrow as well as how much debt it can accumulate. The main provisions of the policy dictate that:

- Debt will be taken on only for capital infrastructure and other investments not to finance programme spending
- Capital infrastructure and investments will be financed with a 50% minimum of cash generated from operating surplus.
- Debt servicing payments not to exceed 5% of the total revenues of government.
- Debt will be repaid according to certain specific rules (in accordance with Fiscal Responsibility Act 2007 as amended).

Theoretical Framework

The theory on which this study is based is dependency theory. The theory explains the nature of the relationship between the countries of the world and the factors that facilitated dependency of one group of countries on the other countries of the world, having been sharply divided along economic prosperity. Countries that are economically buoyant and politically stable are regarded as developed countries, while countries that are economically backward \are termed developing countries or commonly referred to as third world countries. The dependency theory seeks to establish the factors that have propelled or contributed to the development of the underdeveloped countries. This theory is predicated on the assumption that resources flow from a periphery of poor and underdeveloped states to a core of wealthy states enriching the latter at the expenses of the former. According to [14], [15], it is a central contention and stand-point of dependency theory that poor states are impoverished and rich ones enriched by the way poor states are integrated into the world system. Dependency theory states that the poverty of the countries in periphery is not because they are not integrated or fully integrated into the world system as is often argued by free market economists, but because of how they are integrated into the system. There are two schools of thought with different standpoints on the issue. One of these is the bourgeois scholars and the second is radical scholars of the neo-marxion political economy [16]. According to bourgeois scholars, the underdevelopment and the consequent dependence of most TWCs is as a result of their internal contradictions. To them this problem can be explained by their lack of close integration, diffusion of capital, technology and institutions, bad leadership, corruption, mismanagement etc. [17]. To this school of thought, foreign Assistance such as aid, loan, investment etc had allow unhindered operations of the multi-national corporations (MNCs). As a result of underdeveloped nature of most TWCs, they are dependent on the west (developed countries) for virtually everything ranging from technology, aid, technical assistance, loan, to culture etc. This dependent position of TWCs has made them to be susceptible and vulnerable to the machinations of the western metropolitan countries and Breton Woods Institutions [4]. Whether to ascribe the underdevelopment and dependency of the third world countries (TWCs) to eloquent submission of the bourgeois scholars or to the europhorie explanations of the neo-marxian theorist, the fact is that dependency theory explains in details the factors responsible for the position of the TWCs and their constant demand for loans and continuous reliance on foreign loan for their development plans.

Methodology

The research design adopted in this study is ex-post-facto design. This is because the study involves time series data. Secondary data sourced from Central Bank of Nigeria, is used in the study from 1999 to 2020)

Model Specification

The study used ordinary least square (OLS) regression model. The functional relationship between the dependent variable and proxies can be expressed as follow:

$GDP = f(DTSP, EXDT, FXCR, EXTR)$…………………………………. (1)

This model is represented in mathematical terms for purpose of simiplicity as shown below

$GDP = \beta_0 + \beta_1 DTSP + \beta_2 EXDT + \beta_3 FXCR + \beta_4 EXTR$ ……..+ M………… (2)

$GDP = \beta_0 - \beta_4$ = co-efficient of estimates

Where: GDP = Gross Domestic Product
DTSP = Debt Servicing Payment
EXDT = External Debt
FXCR = Foreign Exchange Rate
EXTR = External Reserves
M = Stochastic Variable

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Estimation Procedure:
Johnson Co-intergration

This study adopted a dynamic vector auto regressive regression (VAR) which explores co-integration. The essence is to observe the long-run and short-run dynamics. For instance, given a VAR with possible long run co-integration amongst a set of variables. Therefore, we start with the Johnson Co-integration equation which starts with the vector Auto-regression (VAR) of order P is given by:

Yt = ɱ + Aiut – 1 + …… + Apyt – p + εt ………..

Where: yt is a (n x 1) vetor of variables uniclear consideration in log from that are intergrated at under one

Δyt = ɱ + nμt – 1 + …..+ $\sum_t^p$ = yt -1 + εx

Where: n = $\sum_t^p$ =1 At -1 and εt = $\sum_j^p$ =μtaj

The above equation is a pure Johnson co-integression test. (Gragory and Hansen, 1996) noted that the Johnson test is a test that allows for more than one co-integration relationship.

Error Correction Mechanism (Ecm)

The next step is to estimate the equation using ordinary least square (OLS) technique. Having ascertained whether or not co-integration exists, it is safe to construct the error correction model to model dynamics relationship. The purpose of error correction model is to indicate the speed of adjustment from the short-run equilibrium to long-run equilibrium state. If co-integration is accepted, it suggests that the model is best specified in the first difference of its variables with one period lag of the residual. The advantage of using error correction model (ECM) is that it incorporates the variables at both side levels and first differences.

Estimation and Data Analysis
Simple Regression of GDP on DEBT

variable	Coefficient	Std.Error	t-Statistic	Prob
C	9647.431	5934.790	1.625572	0.1214
GRE	49.29113	5.430860	9.076119	0.0000
R- squared	0.820674	Mean dependent var		49041.55
Adjusted R-squared	0.810712	S.D. dependent var		41604.82
S.E. of regression	18101.13	Akaike info criterion		22.53998
Sum squared resid	5.90E+09	Schwarz criterion		22.63955
log likelihood	-223.3998	Hannan-Quinn Criter		22.55941
F-statistic	82.37594	Durbin-Waston sat		0.786672
Prob(F-statistic)	0.000000			

Source: Author's calculations.

The above table reveals that the regression co-efficient is significant having P.Value of 0.00 and the regressor (Debt) related to regressee (GDP) significantly. (F- statistic = 82.37594, P-Value = 0.00). The R-square is 0.82 and Durbin –Watson statistic = 0.79, with very strong R-Square, though not less than Durbin- Watson statistic. The model indicates a significant good relationship.

Hypotheses Test

t- test of significant relationship between Debt Servicing and Gross Domestic Product in Nigeria.

variable	Coefficient	Std.Error	t-Statistic	Prob
C	9647.431	5934.790	1.625572	0.1214
DEBT	49.29113	5.430860	9.076119	0.0000

Source: Author's calculations

From the table above the t-statistic of significant relationship between government debt servicing and Gross Domestic Product in Nigeria is 9.076 with P. Value of 0.000. Therefore the null hypothesis (H0) can be rejected at level of significant of 0.05. This therefore implies that Debt servicing significantly affected Gross Domestic product in Nigeria.

DISCUSSION OF FINDINGS

From the result of the analysis carried out, it show that debt service payment has significant effect on economic growth in Nigeria. This is partially consistent with the work of [12] which found a mixed outcome. The finding also reveal that external debt is positively related with GDP as indicated by its coi-efficient of 49.29113. The t-test prob.value at 0.0000 shows that external debt significantly impacted on Nigeria economy. The result was further supported by the error of correction test which found a longrun relationship between Debt service and economic growth during the period under review. The analysis also revealed that while external debt on its own showed positive relationship to economic growth and development in Nigeria, external debt servicing indicated negative impact on the economy. The implication of the above is that the country needs to effectively utilize loans procured externally in order to maximize the benefit of the loan

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CONCLUSION AND RECOMMENDATIONS

This paper critically examined the impact of external debt servicing on the performance of Nigerian economy. The main findings emerging from the study indicate that external debt and its servicing have significant impact on the nation's economy, in the short run, while external debt servicing has negative impact on the long-run on the economic growth. Based on the findings of the study, the following recommendations on the policy measures to further enhance the impact of external debt servicing on economic growth in Nigeria were made:

i. External debt should be utilized mainly on basic and infrastructural development in accordance with fiscal responsibility Act, so as help improve on business environment economic output that can make repayment possible.
ii. Government should come out with a proper debt management policy that helps minimize negative effect of debt servicing on the economy
iii. External financing of project should be on only projects with higher priority which can lead to economic growth.
iv. Government should stick to the provisions of fiscal responsibility policy framework by which government will borrow and manage the attendant debt levels and interest cost.

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